

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

Introduction

1. I was engaged to audit the financial statements of Mantsopa Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets and cash flows for the year then ended, statement of comparison of budget and actual amounts, 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 Standards 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 the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment of R713 952 839 (2012: R707 975 497), as disclosed in note 7 to the financial statements. I have not determined the correct net carrying amount of property, plant and equipment or the accuracy of depreciation as it was impractical to do so due to an inadequate asset register that did not agree with the financial statement. I was unable to confirm by alternative means whether the municipality accurately valued all its assets and conducted an impairment assessment of all municipal assets at each reporting date in accordance with SA Standard of GRAP, GRAP 17, *Property, plant and equipment*, GRAP 21, *Impairment of non-cash generating assets* and GRAP 26, *Impairment of cash-generating assets*. Consequently, I was unable to determine whether any adjustments were necessary to the amount disclosed for property, plant and equipment.

Investment property

5. I was unable to obtain sufficient appropriate audit evidence for investment property of R27 271 000 (2012: R27 271 000), as disclosed in note 7 to the financial statements. I have not determined the correct net carrying amount of investment property or the accuracy of depreciation as it was impracticable to do so due to inadequate descriptions and locations

recorded in the asset register to facilitate physical verification of the condition and existence of the assets. I was unable to confirm by alternative means whether the municipality had accurately valued all its assets and conducted an impairment assessment for all municipal assets at each reporting date in accordance with SA Standards of GRAP, GRAP 16, *Investment property* and GRAP 26, *Impairment of cash-generating assets*. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for investment property.

Receivables from exchange transactions

6. I was unable to obtain sufficient appropriate audit evidence to determine the existence and valuation of trade receivable disclosed as R60 171 624 (2012: R104 174 152) in note 10 to the financial statements as the existence of debtors could not be verified. I was unable to confirm the existence of these debtors by alternative means.
7. The municipality made a provision of R87 998 953 (2012: R63 601 512) as disclosed in note 10 to the financial statements 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 adjustments relating to trade receivables in the financial statements were necessary.
8. The municipality did not make all the disclosures as required by the Generally Recognised Accounting Practice, GRAP 104, *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.

Receivable from non-exchange transactions

9. I was unable to obtain sufficient appropriate audit evidence to determine the existence and valuation of trade receivable disclosed as R1 077 780 (2012: R2 685 961) in note 11 to the financial statements as the existence of debtors could not be verified. I was unable to confirm the existence of these debtors by alternative means.

Payables from exchange transactions

10. I was unable to obtain sufficient appropriate audit evidence for payables disclosed as R46 787 996 (2012: R31 863 854) 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 amounts disclosed for payables, expenditure and employee-related costs.

Accumulated surplus

11. I was unable to obtain sufficient appropriate audit evidence as to the completeness, valuation and allocation of the accumulated surplus amounting to R717 138 621 (2012: R767 578 202) 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 adjustments relating to accumulated surplus in the financial statements were necessary.

Provision

12. SA Standards of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*, requires that a provision should be raised 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 (2012: R25 519 511) 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.

Expenditure

13. I was unable to obtain sufficient appropriate audit evidence that invoices were properly recorded and accounted for all expenditure incurred during the current financial year. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to expenditure stated at R280 239 234 in the financial statements were necessary.

Employee-related cost

14. I was unable to obtain sufficient appropriate audit evidence as to the occurrence, accuracy and classification of the employee-related cost disclosed as R52 538 888 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 R3 909 997 with regards to car allowances, overtime and journals. 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 employee-related costs in the financial statements was necessary.

Employee benefits

15. The municipality did not value and disclose post-retirement benefits for the current and prior years in accordance with the Standard of Generally Recognised Accounting Practice, GRAP 25, *Employee benefits*. The municipality did not timeously appoint the actuaries to perform the valuation of the benefits required. I was not able to determine the valuation of the employee benefits as it was impracticable to do so. In addition, the municipality did not adequately disclose long-service awards for the current and prior years.

Consumer deposits

16. 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 158 294 (2012: R1 092 493), 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 adjustments relating to consumer deposits in the financial statements were necessary.

Irregular expenditure

17. I was unable to obtain sufficient appropriate audit evidence that management has identified and recorded all instances of irregular expenditure for the current and prior year as the controls over the system were ineffective and management did not review the entire population to ensure that all instances of irregular expenditure were identified and recorded. I was unable to confirm the irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to irregular expenditure stated at R17 635 757 (2012: R16 216 989) as disclosed in note 41 to the financial statements were necessary.

Fruitless and wasteful expenditure

18. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all fruitless and wasteful expenditure for the current and prior year due to payments made for cell phone account for ex-employees. I was unable to confirm the fruitless and wasteful expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to fruitless and wasteful expenditure stated at R1 198 013 (2012: R410 014) in note 40 to the financial statements were necessary.

Distribution losses and free services

19. 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 R 23 012 245 (2012: R nil) in note 43 to the financial statements due to the incomplete disclosure of losses and unavailability of information. In the absence of sufficient appropriate documents, I was unable to determine the total extent of the misstatement in distribution losses and free services provided.

Cash flow statement

20. 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 in the cash flow statement and related notes.

Disclaimer of opinion

21. 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

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

Significant uncertainties

23. With reference to note 28 to the financial statements, Mantsopa Local Municipality is the defendant in the following court cases: J van As vs. Mantsopa (ex-employee) and Socrapoint (Pty) Ltd. Mantsopa Local Municipality is opposing the claims as it believes that it had not breached any regulations. The outcome of the matter cannot presently be determined and no provision for any liability that may result has been made in the financial statements.

Restatement of corresponding figures

24. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors identified during 30 June 2013 in the financial statements of the Mantsopa Local Municipality at, and for the year ended, 30 June 2012.

Material losses/impairments

25. As disclosed in note 10 to the financial statements, material losses to the amount of R95 966 667 were incurred as a result of a write-off of irrecoverable trade debtors.

Other

26. As disclosed in note 42 to the financial statements, unauthorised expenditure to the amount of R102 498 442 was incurred as a result of overspending on the budgeted amounts.

Additional matter

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

Unaudited supplementary information

28. The supplementary information set out on pages xx to xx does not form part of these 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

29. 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

30. 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

31. 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

32. 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.
33. 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's annual reporting principles and whether the reported performance is consistent with the planned 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* (FMPPi).

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

34. The material findings are as follows concerning the usefulness and reliability of the information.

Usefulness of information

35. A total of 83% of the reported indicators and targets are not consistent with the indicators and targets as per the approved service delivery agreement. This is due to the lack of review by the performance management division.
36. A total of 102% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. A total of 102% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. The required performance could not be measured for a total of 112% of the targets.

Reliability of information

37. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the validity, accuracy and completeness of information presented with respect to basic service delivery, good governance and public participation.

Additional matter

38. I draw attention to the following matter below.

Achievement of planned targets

39. Of the total number of 263 targets planned for the year, 137 were not achieved during the year under review. This represents 52% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

Compliance with laws and regulations

40. I performed procedures to obtain evidence that the entity 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:

Budgets

- 41. Expenditure was incurred 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.
- 42. Quarterly reports on the implementation of the budget and financial state of affairs of the municipality were not submitted to council within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
- 43. Monthly budget statements were not submitted to the provincial treasury, as required by section 71(1) of the MFMA.

Audit committee

- 44. The audit committee did not advise the council on matters relating to internal financial control and internal audits, risk management, 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 council on matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.

Procurement and contract management

- 46. Sufficient appropriate audit evidence could not be obtained that all goods and services with a transaction value of below R200 000 were procured by obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
- 47. Quotations were accepted from prospective providers who are not registered as accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
- 48. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to and accepted from bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by SCM regulations

21(b) and 28(1)(a) and the Preferential Procurement Regulations.

49. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
50. Invitations for competitive bidding were not always advertised for the required minimum period of days, as required by SCM regulation 22(1) and 22(2).
51. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
52. Contracts and quotations were awarded to and accepted from bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
53. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
54. Awards were made to bidders other than those recommended by the bid evaluation committee without ratification by the accounting officer, as required by SCM regulation 29(5)(b).
55. Sufficient appropriate audit evidence could not be obtained that the preference point system was applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
56. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to and quotations were accepted from suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
57. Contracts and quotations were awarded to and accepted from bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.
58. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
59. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act and CIDB regulation 18.
60. Contracts and quotations were awarded to and accepted from providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.
61. Sufficient appropriate audit evidence could not be obtained that contracts and quotations

were only awarded to and accepted from bidders who had submitted 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).

Human resource management

- 62. An acting senior manager was appointed for a period of more than three months, in contravention of section 54A(2A) and 56(1)(c) of the Municipal Systems Act.
- 63. A manager directly accountable to the municipal manager was appointed without submitting certified copies of academic and professional qualifications, in contravention of regulation 4 of GNR 805.

Expenditure management

- 64. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality had always been paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
- 65. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by sections 62(1)(d) and 95(d) of the MFMA.
- 66. An effective system of expenditure control, including procedures for the approval, authorisation and payment of funds, was not in place, as required by section 65(2)(a) of the MFMA.

Transfer of funds and unconditional grants

- 67. The municipality did not submit quarterly performance reports to the transferring national officer, the Free State Provincial Treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
- 68. Unspent conditional grant funds not committed to identifiable projects were not surrendered to the National Revenue Fund, as required by section 21(1) of DoRA.

Asset management

- 69. 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.
- 70. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Predetermined objectives

- 71. The annual performance report for the year under review does not include the performance of each external service providers and a comparison with the previous financial, as required by section 46(1)(a), (b) and (c) of the Municipal Systems Act.
- 72. The municipality did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls, as required by section 62(1)(c)(i) of the MFMA.

Internal control

73. I considered internal control relevant to my 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

74. In the earlier part of the year the leadership 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.
75. 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 and disclosed in the financial statements.
76. Leadership did not ensure that internal control procedures were developed, implemented and monitored to ensure that daily disciplines were performed and reviewed throughout the financial year. Management did not provide effective leadership based on good governance.
77. 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 did not always 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.
78. 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.
79. Leadership did not adequately exercise effective oversight responsibility regarding the municipality's action plan on prior year audit findings.

Financial and performance management

80. The lack of detailed monitoring and implementation of the municipality's action plan on prior year audit findings, as well as staff within the finance directorate of the municipality not having sufficient understanding of the accounting framework, contributed to the errors that were subsequently corrected in the financial statements of the municipality.
81. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing due to lack of competency. This resulted in many findings relating to incorrect disclosure or non-disclosure according to GRAP.
82. The regular review and monitoring of compliance with laws and regulation was not

sufficiently prioritised by management. As a result, material non-compliance issues were noted that could have been prevented. The lack of consequences contributed to the numerous qualifications in the financial statements of the municipality as well as matters reported in respect of compliance, SCM and performance information.

Governance

83. 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.
84. Adequate action was not taken by those charged with governance to address the negative outcomes of the prior year and the implementation and monitoring of a credible action plan to address the matters raised by external audit.
85. The implementation of external audit recommendations was not monitored. This resulted in the prior year audit findings not being substantially addressed.
86. An audit committee did not evaluate and monitor responses to risks and provide oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

AUDITOR-GENERAL

Auditor-General

Bloemfontein

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

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