

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE  
COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF  
MASILONYANA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009  
REPORT ON THE FINANCIAL STATEMENTS

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Masilonyana Local Municipality which comprise the balance sheet as at 30 June 2009, the income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

**The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basic of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) 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.

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, 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 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

**Basis for disclaimer of opinion**

**Bank overdraft**

4. I was unable to obtain sufficient appropriate audit evidence in respect of debit and credit journals amounting to R41 251 227 and R1 931 601 (2008: R57 341 049), respectively, processed in the bank ledger account. Numerous unreconciled transactions, some of which dated back to July 2008 were noted on the year-end bank reconciliation. I could therefore not confirm the completeness and valuation of the bank overdraft balance of R5 225 804 as disclosed in the balance sheet. The records of the municipality did not permit me to perform reasonable alternative procedures in respect of these transactions.

**5. Fixed assets**

The assets of the municipality were not marked with a unique identification mark/ number in terms of paragraph 10.1 of the council's fixed asset management policy. Furthermore, location plan detail regarding sewerage, water and electricity networks as well as bucket eradication could not be provided. There were also various assets found in the asset register with incomplete descriptions / locations or without any cost prices. In other instances the ownership of properties could not be proved or were assets not capitalized or duplicated. The existence, completeness, valuation, rights and obligations of assets amounting to R279 548 122 as disclosed in note 6 to the financial statements could not be verified as correct and the financial reporting system did not make provision for alternative procedures to be performed.

6. Assets as disclosed in note 6 to the financial statements differed by R22 498 600 from the amount as per the asset register. The existence, completeness and rights and obligations of the amounts disclosed in the financial statements could thus not be confirmed as correct. The financial reporting system did not make provision for alternative audit procedures to confirm these amounts.
7. Supporting documentation for debit and credit journals amounting to R7 772 509 and R3 786 770, respectively, could not be provided. The completeness and rights and obligations of these amounts could thus not be confirmed as correct. The financial reporting system did not make provision for alternative procedures to be performed to confirm these amounts.

#### Debtors

8. I was unable to obtain sufficient appropriate audit evidence as to the existence, valuation and the municipality's rights to suspense debtors of R3 062 064 as disclosed in note 10 to the financial statements. The records of the municipality also did not permit me to perform reasonable alternative procedures in respect of this balance.

#### Creditors

9. Supporting documentation for a sundry creditor of R47 586 436 could not be provided. Consequently, I could not confirm the completeness, existence, valuation and the municipality's obligation of the suspense creditors included in note 12 to the financial statements as the financial reporting system did not make provision for reasonable alternative procedures to be performed.
10. I was unable to obtain sufficient appropriate audit evidence as to the existence, valuation and the municipality's obligation in respect of trade creditors of R6 847 102 (which included journals of R3 969 865) presented in the balance sheet and included in note 12 to the financial statements. This was mainly due to a lack of internal controls to effectively manage creditors and the fact that proper reconciliations were not done. The municipalities' records and systems did not permit me to perform reasonable alternative procedures in respect of these balances.

#### Income

##### Assessment rates

11. Management could not explain or provide sufficient appropriate audit evidence regarding the significant decrease in the assessment rate income from R11 259 388 in 2008 to R9 829 470 for the year under review. In the absence of a reconciliation between the official valuation roll and the accounting system, I was unable to confirm the completeness of assessment rates income as disclosed in note 13 to the financial statements. The records of the municipality also did not permit me to perform reasonable alternative procedures in respect of this balance.

##### Other income

12. Traffic income included in rates and general services in the income statement to the financial statements decreased from R147 920 in 2008 to R67 300 in the current year. Explanations for the decrease could not be obtained. The completeness and accuracy of this amount could not be confirmed. The municipality's records and systems did not permit me to perform reasonable alternative procedures in respect of this balance.

#### Government grants

13. Included in the equitable share grants of R42 243 657, as disclosed in note 26 to the financial statements, was an amount of R9 796 030 for which supporting documentation could not be provided. The completeness and valuation of equitable share allocations could therefore not be confirmed. The municipal records also did not permit me to perform reasonable alternative procedures in respect of the transaction.

#### Expenditure

14. Due to inadequate control measures, expenditure amounting to R9 559 170 was paid after 30 June 2009 while the services were rendered before year-end, resulting in both expenditure and creditors being understated by this amount as it was not recorded in the correct period.
15. Supporting documentation for expenditure amounting to R4 869 823 (2008: R9 689 587) as included in the income statement could not be provided. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, accuracy and classification of this expenditure. The records of the municipality also did not permit me to perform reasonable alternative procedures in respect of these transactions.
16. Supporting documentation for payments amounting to R2 719 717 from the investment account could not be provided. The completeness and accuracy of the withdrawal and the utilisation thereof could not be confirmed. The municipality's records and systems did not permit me to perform reasonable alternative procedures in respect of this balance.

#### Inventory

17. A proper inventory system for the recording of purchases of fuel, chemicals and uniforms during the year amounting to R4 218 399 did not exist. Furthermore, no basis for the issuing of these inventories could be found. The fraudulent use of municipal resources could not be excluded. As a result, the completeness, existence and rights and obligations of R84 360 as reflected in note 9 to the financial statements could not be determined. The municipality's records and systems did not permit me to perform reasonable alternative procedures in respect of this inventory balance.

#### Accumulated deficit

18. I was unable to obtain sufficient appropriate audit evidence of transactions totalling R8 985 470 allocated to the appropriation account. As a result the completeness and valuation of the accumulated deficit balance of R77 945 355 as reflected in note 17 to the financial statements could not be confirmed. The municipality's records also did not permit me to perform reasonable alternative procedures to confirm of these amounts.

#### Reserves

19. An unspent conditional grant reserve amounting to R11 725 306 included in notes 2 and 3 to the financial statements could not be confirmed. The purpose and approval for the creation of this reserve could not be established and there was also no accounting policy included in the financial statements explaining the purpose of this reserve. I could not confirm the completeness and rights and obligations in this regard. The records of the municipality also did not permit me to perform reasonable alternative procedures to confirm this amount.

### Value-added tax (VAT)

20. The completeness, valuation and rights and obligations of the VAT balance of R4 367 073 as disclosed in note 10 to the financial statements could not be confirmed due to the following:
- Consumer debtors amounting to R48 112 687 were written off against the provision for bad debts without taking into account the VAT portion to the VAT control account. A detail write-off list was not available and due to the lack of VAT reconciliations it could not be confirmed if the VAT on this writing off of debt, estimated at R4 619 239, was claimed from the South African Revenue Service (SARS). The records of the municipality also did not permit me to perform reasonable alternative procedures to confirm this transaction.
  - No VAT reconciliations were performed for the current or previous year to substantiate journals processed and no supporting documentation could be obtained for debit and credit journals amounting to R8 621 872 and R5 022 644, respectively. The completeness and accuracy of VAT returns could not be confirmed and the records of the municipality did not permit me to perform reasonable alternative procedures.
  - A difference of R84 150 153 (2008: R29 738 215) was identified between the amounts on the bank statements and the income declared on the VAT 201 returns submitted to SARS. Management was unable to provide me with sufficient and appropriate audit evidence in respect of these identified differences and thus I was unable to consider the occurrence, accuracy and classification of allocations to the VAT output account.

### Cash flow statement

21. A difference of R1 921 342 was identified between the movement in debtors as per the balance sheet and the amount as disclosed in the cash flow statement. Management was unable to provide me an explanation or sufficient appropriate audit evidence in respect of the identified difference and the records of the municipality did not permit me to perform reasonable alternative procedures to confirm this amount. I was thus unable to perform all the procedures that I deemed necessary to express an opinion as to whether fair presentation of the cash flow for the year under review was achieved in the statement.
22. I was not able to determine whether the cash flow statement and related notes are fairly stated due to the material effect on the cash flow statement and the related notes of scope limitations and identified misstatements as reported in this report.

### Capital commitments

23. I was unable to obtain sufficient appropriate audit evidence as to the existence and valuation of capital commitments of R27 327 389 included in the amount of R39 052 694 (2008: R13 540 000) as disclosed in note 25 to the financial statements. The records of the municipality did not permit me to perform reasonable alternative procedures in respect of this balance.

### Contingent liabilities

24. In terms of section 125(2)(c) of the MFMA the notes to the financial statements of a municipality must disclose particulars of any contingent liability. Contingent liabilities amounted to R197 474 is disclosed in note 24 to the financial statements, but appropriate supporting documentation could not be obtained to confirm the completeness of this amount. The municipality's records did not permit me to perform reasonable alternative procedures in respect of this balance.

### **Irregular expenditure**

25. The following irregular expenditure was identified during the audit, but was not disclosed as such, as required by section 125(2)(d)(i) of the MFMA:
- Vehicles were hired during the period under review. No tenders in terms of chapter 7, paragraph 7.1.1, of the supply chain management policy were invited for transactions amounting to R4 358 586. Irregular expenditure of R4 358 586 was incurred as a proper tender process had not been followed. If these equipment was bought it would have costed approximately R3 809 500 and the council would have had assets to this value. The difference of R681 903 is considered to be wasteful expenditure. The possibility of fraud could not be excluded.
  - The municipality's procurement policy, chapter 3, paragraph 6.1.1 and chapter 7, paragraph 7.1.1, were not adhered to in all instances, resulting in payments totalling R4 216 475 (2008: R3 815 027), where the required number of quotations and/or tenders were not obtained for purchases made.

The completeness of irregular expenditure could not be confirmed as the records and systems of the municipality did not permit reasonable alternative procedures in this regard.

26. Councillor remuneration exceeded the amounts stated in the *Government Gazette No. 31687*, dated 8 December 2008, by a total amount of R355 165 (2008: R130 931; 2007: R763 181 and 2006: R85 500) for the year. This is regarded as irregular expenditure in terms of section 1 of the MFMA. No corrective steps have been taken by management to recover any of these overpayments during the last four years. As a result councillor allowances are considered as being overstated.

### **Fruitless and wasteful expenditure**

27. Fruitless and wasteful expenditure amounting to R1 381 689 was incurred as a result of interest and penalties paid. This was not disclosed in the notes to the financial statements as required by section 125(2)(d) of the MFMA.
28. I could not be provided with sufficient, appropriate audit evidence that management has properly identified, investigated and recorded all fruitless and wasteful expenditure transactions during the year under review. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance regarding the completeness of fruitless and wasteful expenditure as disclosed.

### **Unauthorised expenditure**

29. As disclosed in note 29.2 to the financial statements unauthorised expenditure of R34 264 485 was incurred as provision for bad debt was not budgeted for. This amount is also understated by R6 287 267 due to the overspending on the capital budget during the year under review.

### **Disclaimer of opinion**

30. 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 matter

I draw attention to the following matter on which I do not express a disclaimer of opinion:

#### Going concern

31. As disclosed in note 30 to the financial statements the municipality indicated that they might experience challenges over the next 12 months to meet some of its obligations. These conditions, along with other matters, point to the existence of a material uncertainty that might cast significant doubt on the municipality's ability to continue as a going concern.

#### Basis of accounting

32. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting as set out in accounting policy note 1.

#### Other matters

#### Unaudited supplementary schedules

33. 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 information included in the annual report

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

#### Non-compliance with applicable legislation

#### Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)

35. Various instances of non-compliance with the MFMA were observed, which included the following:

Section	Detail
54(1)(c)	Evidence could not be found that service delivery targets and performance indicators as per the service delivery and budget implementation plan were revised with the October 2008 adjustment budget.
63(1)(a)	The accounting officer is responsible for the safeguarding and maintenance of assets and various assets were found to be not appropriately maintained.
65(2)(e)	Payments totalling R6 112 030 were not paid within 30 days of receipt of invoices.
121(3)	An annual report of the municipality that include the financial statements, the Auditor-General's report, the annual performance report and any information as determined by the municipality was not prepared for the 2007-08 financial year.
125(1)(c)	The notes to the financial statements of a municipality must include amounts outstanding in respect of pension and medical aid contributions.

**Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)**

36. Instances of non-compliance with the MSA found during the audit are the following:

Section	Detail
57	Separate annually concluded performance agreements with each manager directly accountable to the municipal manager could not be obtained.
66	A staff establishment which also indicates job descriptions and remuneration and condition of service as well as the regular evaluation of staff could not be submitted.
Schedule 1	Declarations of interest could not be obtained for councillors (paragraph 5 of the Code of Conduct for Councillors) or managers (paragraph 5 of the Code of Conduct for Municipal Staff Members) for the year under review.

**Governance framework**

37. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

**Internal control deficiencies**

38. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control (The number listed per component can be followed with the legend below the table). In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4	Bank overdraft	5	4;5			
5-7	Fixed assets	5,6				1
8	Debtors	5				
9-10	Creditors	5				1
11-13	Income	5				
14-16	Expenditure	2,6				
17	Inventory	5				
18	Accumulated deficit	5				
19	Reserves			4		
20	Value-added tax	5		6		
21-22	Cash flow statement	2				

23	Capital commitments	5				
24	Contingent liabilities	5				
25-26	Irregular expenditure	5	5	6		1
27-28	Fruitless and wasteful expenditure	5				
29	Unauthorised expenditure	5				

**Overall conclusion on the governance framework based on internal control deficiencies as and where applicable:**

39. The lack of control over documents and the lack of care taken by employees to ensure the availability thereof are considered to be the main root cause for the disclaimer of audit opinion. The staff did not exercise ownership of, and responsibility for, the tasks allocated to them. The accounting officer did not take sufficient or appropriate action to address the lack of discipline. The accounting officer and chief financial officer did not monitor the correction and updating of records and reconciliations and supervision over accounting of fixed assets, fruitless and wasteful and irregular expenditure was lacking.

Legend	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes	3



and responsibilities by personnel.	
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

**Key governance responsibilities**

40. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).	X	
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.	X	
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.		X
	• The audit committee operates in accordance with approved, written terms of reference.		X
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		X
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.		X
	• The internal audit function operates in terms of an approved internal audit plan.		X
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		X

8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned, as set out in section 79 of the MFMA.	X	
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented.		X
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Masilonyana local municipality against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA).		X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

**Overall conclusion on the governance framework based on other key governance requirements, as and where applicable**

- 41. The vacancy left by the municipal manager and the fact that the chief financial officer was appointed as acting municipal manager and also performed his normal duties resulted in delays and non-availability during the audit process and the delivery of documentation.
- 42. The financial statements were not reviewed timeously before submission for auditing by the chief financial officer, resulting in various amendments to be made afterwards.
- 43. The accounting officer did not prioritise the implementation of oversight regarding the audit committee, an internal audit unit, a proper financial and internal control system, a fraud prevention plan and risk assessment as required in terms of the MFMA as well as the compilation of an annual report. Furthermore, an action plan was not drawn up to address prior year audit findings and SCOPA resolutions.

**REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

**Report on performance information**

- 44. I was engaged to review the performance information.

**The accounting officer's responsibility for the performance information**

- 45. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of

section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

#### **The Auditor-General's responsibility**

46. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057* of 15 May 2008 and section 45 of the MSA.
47. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
48. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

#### **Findings of performance information**

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

##### **No reporting on performance information**

49. The accounting officer did not prepare an annual performance report in terms of section 46 of the MSA. This could be attributed to the lack of prioritising the reporting of performance information, the lack of management oversight as well as the lack of effective performance management system.

#### **APPRECIATION**

50. The assistance rendered by the staff of the Masilonyana Local Municipality during the audit is sincerely appreciated.

Bloemfontein

18 December 2009



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*