

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

REPORT ON THE ANNUAL FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying annual financial statements of the Masilonyana Local Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages XX to XX.

Accounting officer's responsibility for the annual financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these annual 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, 2010 (Act No.1 of 2010 as amended) (DoRA) , and for such internal control as management determines necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the annual financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, 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. Due to the matters listed below, I was unable to verify that items of property, plant and equipment of R429 171 750 (2010: R394 310 574) as disclosed in note 7 to the annual financial statements, were accounted for at the correct value, that these items did exist at year-end, that the municipality had control over these items and that the balance reflected in the annual financial statements includes all the municipality's items of property, plant and equipment. The system of control over items of property, plant and equipment was not sufficient to provide me with alternative means to perform my audit on these items:
 - For assets with a cost price of R100 444 814 (2010: R330 061 477) the descriptions, serial numbers and locations of these items, as indicated in the fixed asset register, were inadequate for identification purposes. Furthermore, property, plant and equipment amounting to R133 063 052 (2010: R18 454) was omitted from the fixed asset register and subsequently from the annual financial statements. Consequently, I was unable to

perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, valuation and allocation and completeness of and the municipality's rights to property, plant and equipment to this amount.

- Documentation to support debit transactions amounting to R11 509 495 and credit transactions amounting to R3 930 551 as recorded in the general ledger, could not be submitted for audit purposes. In the absence of these documents, I was unable to confirm the existence, valuation, allocation and completeness of and the municipality's rights to property, plant and equipment.
 - Opening balances were reclassified for various classes of property, plant and equipment; these reclassifications were not disclosed in the comparative amounts for property, plant and equipment. Furthermore, an unexplained difference of R998 052 was identified on the carrying value of the comparative amount between note 7 and note 30. Consequently, I was unable to confirm the valuation and allocation and completeness of property, plant and equipment.
 - Documentation to support the separation of land and buildings disclosed as R95 168 372 and R3 514 726, respectively, in the annual financial statements could not be submitted for audit purposes. Furthermore, no accounting policy was included in the annual financial statements for land and buildings. In the absence of supporting documentation and an accounting policy, I was unable to confirm the valuation and allocation of land and buildings.
 - The municipality did not review the residual values, useful lives and depreciation methods of property, plant and equipment at each reporting date in accordance with paragraphs 61 and 71 of SA Standards of GRAP, GRAP 17, *Property, plant and equipment*. Consequently, I could not obtain sufficient audit evidence to confirm the valuation of property, plant and equipment and the accuracy of depreciation charges as disclosed in note 24 to the financial statements.
 - Paragraph 53 of SA Standards of GRAP, GRAP 17, *Property, plant and equipment*, requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. Major components of some items of property, plant and equipment were not accounted for and depreciated separately. Consequently, I could not obtain sufficient audit evidence to confirm the valuation of property, plant and equipment and the accuracy of depreciation charges as disclosed in note 24 to the financial statements.
 - A difference of R468 569 was identified between the value of land in the asset register and the values of land on the valuation roll. Sufficient supporting documentation could not be provided for this difference. Consequently, I was unable to determine the extent of the misstatement in the disclosed property, plant and equipment balance.
5. SA Standards of GRAP, GRAP 17, *Property, plant and equipment*, states that the carrying amount of an item of property, plant and equipment shall be derecognised when no future economic benefits or service potential are expected from its use or disposal. It was identified that assets with a cost price of R17 676 734 were not in a working condition. These assets were not removed from the asset register and were still included in note 7 to the annual financial statements, resulting in the overstatement of property, plant and equipment, as well as an understatement in the disclosed expenditure.

Investment property

6. Paragraph 5 of SA Standards of GRAP, GRAP 16, *Investment property*, requires an asset to be recognised as investment property when it is property held to earn rentals or for capital appreciation, or both. Paragraphs 2 and 18 of SA Standards of GRAP, GRAP 16, *Investment property*, require a municipality to disclose investment property separately in the annual financial statements. Management did not complete their processes of separating investment property from property, plant and equipment. Consequently, I could not obtain adequate audit assurance as to the completeness, valuation, allocation and existence of investment property in the annual financial statements for the financial years ended 30 June 2011 and 30 June 2010. The municipality's records and information available did not permit the application of alternative audit procedures regarding investment property.

Accumulated surplus

7. Documentation to support debit transactions amounting to R31 069 089 and credit transactions amounting to R41 817 795 recorded could not be submitted for audit purposes. Consequently, I was unable to confirm the completeness, existence, rights and obligations, valuation and allocation of accumulated surplus disclosed as R363 837 440 (2010: R312 958 426) in the statement of financial position and statement of changes in net assets. The municipality's records and information available did not permit the application of alternative audit procedures regarding accumulated surplus.

Revenue

8. Due to the matters listed below, I was unable to obtain sufficient appropriate audit evidence to verify that revenue of R176 650 582 (2010: R129 601 583) as disclosed in the statement of financial performance, was accounted for accurately, that these transactions occurred during the financial year, that the municipality recorded the transactions in the correct financial year and to the correct accounts and that the amount reflected in the annual financial statements included all the revenue of the municipality. The municipality's records did not permit the application of alternative audit procedures regarding revenue.
 - Documentation to support debit transactions amounting to R2 056 284 and credit transactions amounting to R6 934 782 recorded could not be submitted for audit purposes. In the absence to these documents, I was unable to confirm the occurrence, completeness, accuracy, cut off and classification of revenue.
 - Services were not calculated and charged on a monthly basis by the municipality to all debtor accounts. The municipality also did not have complete building plans indicating all sewerage and refuse points within the municipal area. This therefore resulted in consumers not being levied each month for sewerage, refuse, water, electricity and property rates. In the absence of this information, I was unable to calculate what the service charge against revenue and consumer debtors should have been. Consequently, I could not obtain sufficient audit evidence to confirm the accuracy and completeness of service charge revenue and the completeness and valuation of consumer debtors.
 - An unexplained difference of R84 717 394 was identified between the approved valuation roll and the valuation roll on the system, which is used to levy property rates. I was therefore unable to perform all the procedures that I deemed necessary to confirm the occurrence, completeness and accuracy of property rates disclosed as R12 980 050 (2010: R7 374 579) in note 17 to the annual financial statements.

- The municipality did not maintain direct income registers, which provide particulars of other income received. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of revenue.
 - Contrary to the requirements of paragraph 39(a) of SA Standards of GRAP, GRAP 9, *Revenue from exchange transactions*, the accounting policy of revenue did not state how the recognition of revenue including the methods adopted to determine the stage of completion of transactions involving the rendering of services was determined.
9. Contrary to the requirements of paragraph 31 of SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, the municipality did not provide for service charges relating to the period between the last meter reading date and the year-end date on an annual basis. Based on my calculations, service charges as well as consumer debtors and other receivables are both understated by R254 801 (2010: R939 678).

Payables

10. Due to the matters listed below, I was unable to verify that items of trade and other payables from exchange transactions and other payables disclosed as R59 847 059 (2010: R62 375 106) in note 14 to the annual financial statements, were accounted for at the correct value, that these payables did exist at year-end, that the balance outstanding is payable by the municipality and that the balance disclosed included all the municipality's payables. The municipality's records and information available did not permit the application of alternative audit procedures regarding payables:
- Documentation to support debit transactions amounting to R69 836 640 and credit transactions amounting to R48 518 988 recorded could not be submitted for audit purposes. In the absence of these documents, I was unable to confirm the existence, valuation and allocation, completeness of and the municipality's obligations to payables.
 - Documentation to support debtors with credit balances amounting to R5 760 261 (2010: R208 417) and other current liabilities disclosed in the statement of financial position amounting to R20 182 872 (2010: R12 936 836) could not be submitted for audit purposes. In the absence of these documents, I was unable to confirm the existence, valuation and allocation, completeness of and the municipality's obligations to payables.
 - A difference of R12 510 161 (2010: R4 406 038) between the disclosed balance of R20 079 845 (2010: R29 985 388) and the financial report of R7 569 684 (2010: R25 579 350) could not be explained. Consequently, I was unable to verify the existence, completeness, valuation and allocation of and municipality's obligations to payables.
 - Bid documents and final accounts of completed projects to support retentions disclosed in the annual financial statements could not be obtained for audit purposes. Furthermore, the basis used by the municipality for determining retentions could not be determined. In the absence of these documents, final accounts and the basis used, I was unable to confirm the completeness, existence, valuation and allocation of and the municipality's obligations to retentions amounting to R4 460 898 (2010: R1 851 853).
 - Paragraph 47 of the South African Statements of Generally Accepted Accounting Practice (SA Statements of GAAP), IAS 39, *Financial instruments: Recognition and measurement*, states that after initial recognition, an entity shall measure financial liabilities at amortised cost using the effective interest method. Contrary to the requirements, trade and other payables from exchange transactions and other payables as disclosed in note 14 to the annual financial statements were not measured at

- amortised cost. As the relevant information was not available I could not determine the amounts by which trade and other payables from exchange transactions and other payables and interest were misstated. Consequently, I could not obtain sufficient audit evidence to confirm the completeness and valuation of trade and other payables from exchange transactions and other payables and accuracy and completeness of interest.
 - An unreconciled difference of R513 064 (2010: R2 588 331) was identified between the creditor statements and the creditor's age analysis. I could not be provided with sufficient supporting documentation to reconcile this difference. Consequently, the completeness, valuation and allocation of trade payables from exchange transaction could not be confirmed.
 - The completeness and valuation of staff leave disclosed as R4 646 280 (2010: R3 133 643) in note 14 to the annual financial statements could not be confirmed, as leave days were incorrectly accrued for. As the relevant information was not available I could not determine the amounts by which trade and other payables from exchange transactions and other payables and expenditure were misstated.
11. The municipality has been granted exemption for payments to the compensation fund in terms of subsection 2 of paragraph 84(1)(a)(iii) of the Compensation for Occupational Injuries and Disease Amendment Act, 1997 (Act No. 61 of 1997). Contrary to this, the municipality erroneously made an accrual of R1 902 792 (2010: R1 902 792) as disclosed in note 14 to the annual financial statements.
12. Contrary to the SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, the municipality did not account for all trade payables. Based on my calculations, I have assessed the understatement of trade payables and expenditure at R9 248 978 (2010: R2 171 335).
13. SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Creditors with debit balances amounting to R1 622 495 were not reclassified as trade and other receivables, resulting in an understatement of trade and other payables and trade and other receivables by the said amount.

Expenditure

14. Due to the matters listed below, I was not able to verify that expenditure disclosed as R52 222 544 (2010: R49 671 128) in the statement of financial performance, was accounted for accurately, that these transactions occurred during the financial year, that the municipality recorded the transactions in the correct financial year and to the correct accounts and that the amount reflected in the annual financial statements included all the expenditure of the municipality. The municipality's records and information available did not permit the application of alternative audit procedures regarding expenditure.
- Documentation to support debit transactions amounting to R34 702 663 (2010: R14 798 101) and credit transactions amounting to R2 848 832 recorded could not be submitted for audit purposes. Furthermore, monthly rental reports for operating lease payments amounting to R1 052 968 were not provided for audit purposes. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, completeness, accuracy, cut off and classification of expenditure.
 - The depreciation charge on property, plant and equipment as disclosed in note 24 to the annual financial statements amounted to R4 000 207 (2010: R3 836 893). However, due

to the matters listed in paragraph 4 above, I was unable to obtain adequate audit assurance as to the accuracy of the depreciation charge.

15. SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Differences were identified between the general ledger and the supporting documentation. Based on my calculations, expenditure as well as trade and other payables were both understated by R1 335 405.
16. SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, requires that the financial statements should present fairly the financial performance of the municipality. Expenses amounting to R589 240 were recorded in the incorrect accounting period. Consequently, expenditure was overstated by R589 240.
17. The municipality expensed assets, which had to be recognised in terms of the SA Standards of GRAP, GRAP 17, *Property, plant and equipment*, and SA Standards of GRAP, GRAP 12, *Inventories*. Based on my calculations repairs and maintenance were therefore overstated by R1 610 975, property, plant and equipment understated by R942 180 and inventory understated by R668 795.

Employee-related costs

18. Sufficient appropriate audit evidence could not be obtained for employee-related cost payments of R18 866 477 (2010: R8 367 693) made during the year under review. Consequently, I was unable to confirm the occurrence, accuracy, classification, cut off and completeness of employee-related cost of R45 195 076 (2010: R47 419 838) as disclosed in note 22 to the annual financial statements. The municipality's records and information available did not permit the application of alternative audit procedures regarding employee-related costs.

Receivables

19. Due to the matters listed below, I was unable to verify that consumer debtors and other receivables of R18 555 901 (2010: R3 732 183), as disclosed in note 3 and 4 to the annual financial statements, were accounted for at the correct value, that these receivables did exist at year-end, that the balance outstanding is payable to the municipality and that the disclosed balance included all the municipality's receivables. The municipality's records and available information did not permit the application of alternative audit procedures regarding receivables:
 - Sufficient appropriate audit evidence could not be obtained that the municipality had assessed the recoverability (impairment) of its consumer and other debtors in terms of the requirements of SA Statements of GAAP, IAS 39, *Financial instruments: Recognition and measurement*. The municipality only made a general provision based on the ageing of the outstanding debt. Consequently, I was unable to determine the impact of non-compliance with this accounting standard on the annual financial statements, as well as the valuation of the provision of doubtful debts of R164 171 676 (2010: R145 120 993), as disclosed in note 3 to the annual financial statements and the accuracy of the debt impairment of R19 560 579 (2010: R26 555 442), as disclosed in the statement of financial performance. Furthermore, the value-added tax (VAT), debt impairment and accumulated surplus implications on the general provision were also uncertain and had not been considered by the municipality.

- Paragraph 46(a) of SA Statements of GAAP, IAS 39, *Financial instruments: Recognition and measurement*, states that after initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except, amongst others, for loans and receivables as defined in paragraph 9, which shall be measured at amortised cost using the effective interest method. Contrary to the requirements, consumer debtors and other receivables and other receivables from non-exchange transactions as disclosed in notes 3 and 4 to the annual financial statements were not measured at amortised cost. As the relevant information was not available I could not determine the amounts by which consumer debtors and other receivables as well as other receivables from non-exchange transactions and interest were misstated. Consequently, I could not obtain sufficient audit evidence to confirm the completeness and valuation of consumer debtors and other receivables as well as other receivables from non-exchange transactions and the accuracy and completeness of interest.
- In the absence of payments made after year-end, I could not verify the existence of receivables from exchange and non-exchange transactions of R181 151 088 (2010: R90 295 710) as disclosed in notes 3 and 4 to the annual financial statements.
- Documentation to support debit transactions amounting to R16 307 042 recorded could not be submitted for audit purposes. In the absence of these documents, I was unable to confirm the existence, valuation and allocation, completeness of and the municipality's rights to receivables.
- The SA Statements of GAAP, IFRS 7 (AC144), *Financial instrument: Disclosures*, SA Statements of GAAP, IAS 32, *Financial instruments: Presentation* and SA Statements of GAAP, IAS 39, *Financial instruments: Recognition and measurement*, require that debtors in the notes to the annual financial statements should be disclosed by category of consumer, specifically identifying those amounts owed by other spheres of government and there should be an age analysis by major revenue in the notes to the annual financial statements. Contrary to the requirements, consumer debtors and other receivables as disclosed in note 3 to the annual financial statements did not disclose the age analysis by major revenue source and receivables by customer classification.
- Sufficient appropriate audit evidence could not be provided for a suspense account of R2 316 623 (2010: R1 295 456) disclosed as consumer and other receivables in note 3 to the annual financial statements. This suspense account was not cleared at year-end, as required by section 65(2)(j) of the MFMA. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, completeness, valuation and allocation of and municipality's rights pertaining to the suspense account.
- A difference of R2 189 378 (2010: R3 107 044) between the disclosed balance of R182 710 430 (2010: R145 311 275) and the financial report of R180 521 052 (2010: R142 204 231) could not be explained. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all receivables were properly accounted for. Consequently, I was unable to verify the existence, completeness, valuation and allocation of and rights to receivables.
- Due to severe shortcomings noted within the municipality's system regarding the completion, verification, approval and filing of indigent applications, I could not verify the status of several consumer debtors as being indigent. Consequently, I was unable to verify the existence of the indigent debtors.

Value-added tax (VAT) payable

20. The municipality's accounting system was inadequate to account for VAT and therefore the general ledger accounts were not used for VAT calculation purposes. During the audit several cases were identified where input VAT was not claimed on claimable expenditure and where input VAT was erroneously claimed. Furthermore, no VAT reconciliations were performed. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance regarding the VAT payable. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the completeness, existence, valuation and allocation of and the municipality's obligations to the VAT payable of R14 763 110 (2010: R11 575 273) as disclosed in note 5 to the annual financial statements.

Cash and cash equivalents

21. Documentation to support debit transactions amounting to R7 956 777 (2010: R41 986 227) and credit transactions amounting to Rnil (2010: R1 931 601) recorded could not be submitted for audit purposes. The municipality's records and information available did not permit the application of alternative audit procedures regarding cash and cash equivalents. Consequently, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, rights and obligations, valuation and allocation of cash and cash equivalents of R6 484 797 (2010: R203 125), as disclosed in note 6 to the annual financial statements.

Provisions

22. I could not obtain sufficient appropriate audit evidence regarding the provision for environmental rehabilitation of R1 200 000 (2010: R1 200 000) as disclosed in note 12 to the annual financial statements. In the absence of sufficient appropriate audit evidence, I was unable to confirm the valuation, allocation and completeness of this liability at year-end and could consequently not determine the effect on the other account balances and classes of transactions contained in the annual financial statements. The municipality's records and information available did not permit the application of alternative audit procedures regarding provisions.

Employee benefits

23. Due to the matters listed below, I was unable to verify that items of employee benefits disclosed as R4 812 260 (2010: R4 811 830) in note 12 to the annual financial statements, were accounted for at the correct value, that these employee benefits did exist at year-end and that the balance disclosed included all the municipality's employee benefits. The municipality's records and information available did not permit the application of alternative audit procedures regarding employee benefits:
- Paragraph 58 of the SA Statements of GAAP, IAS 19, *Employee benefits*, states that the municipality should assess the results of the actuarial valuation and ensure that it is updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period. Furthermore, SA Statements of GAAP, IAS 19, *Employee benefits*, outlines the recognition and disclosure requirements pertaining to post-employee benefit plans. Contrary to these requirements, the municipality did not assess the results of the actuarial valuation to ensure that it was updated for any material transactions and other material changes in circumstances up to the end of the reporting period, 30 June 2011, and did not adequately disclose these recognition and disclosure requirements in the

annual financial statements. In the absence of updated actuarial valuations, I was unable to gain adequate audit assurance as to the valuation and completeness of the liability at reporting date and could consequently not determine the effect on the other account balances and classes of transactions contained in the annual financial statements.

- I could not obtain sufficient appropriate audit evidence regarding the provision for long-term service awards of R611 672. Furthermore, no provision has been made for service bonuses. In the absence of sufficient appropriate audit evidence and appropriate records and information, I was unable to confirm the valuation and allocation and completeness of employee benefits at year-end and could consequently not determine the effect on the other account balances and classes of transactions contained in the annual financial statements.

Unspent conditional grants

24. I could not be supplied with sufficient appropriate audit evidence to establish if all transactions took place according to the conditions of each grant and whether the expenditure against the grants should have been transferred to revenue in the statement of financial performance. Furthermore, a difference of R1 000 000 was identified between the annual financial statements and the amounts per the bank statements and the municipality did not provide accurate reconciliations of the balance of unspent grants at the beginning of the year to the balance unspent at the end of the financial year. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the completeness, existence, valuation and allocation as well as the municipality's obligations of unspent conditional grants of R2 992 736 (2010: R3 786 765) as disclosed in note 16 to the annual financial statements as well as the occurrence, accuracy, classification and completeness of revenue from grants and subsidies.

Finance lease liability

25. Paragraph 34 of SA Standards of GRAP, GRAP 13, *Leases*, states that at the commencement of the lease term, lessees shall recognise finance leases as assets and liabilities in their statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Paragraphs 46 and 50 of SA Standards of GRAP, GRAP 13, *Leases*, have various disclosure requirements for finance leases and operating lease, respectively. Contrary to these requirements, sufficient supporting evidence could not be obtained to confirm the finance lease liability disclosed as R1 711 476 in note 13 to the annual financial statements. Various disclosure requirements were also not made. Consequently, I was unable to perform satisfactorily audit procedures to obtain reasonable audit evidence on the valuation and allocation, existence and the municipality's obligations pertaining to the finance lease liability. The municipality's records and information available did not permit the application of alternative audit procedures regarding finance lease liability.

Inventory

26. Due to the matters listed below, I was not able to verify that inventory disclosed as R183 129 (2010: R379 356) in note 2 to the annual financial statements, was accounted for at the correct value and that the balance reflected in the annual financial statements included the entire municipality's inventory. The municipality's records and information available did not permit the application of alternative audit procedures regarding inventory:
- Paragraph 17 of SA Standards of GRAP, GRAP 12, *Inventories*, states that inventory shall be measured at the lower of cost and net realisable value, except where paragraph 18 applies. Contrary to the requirements, sufficient supporting evidence could not be obtained to verify that inventory was valued at the lower of cost and as stipulated in the municipality's accounting policy. Furthermore, the amount of inventory recognised as an expense during the period was not disclosed in the annual financial statements. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and allocation and completeness of inventory and accuracy and completeness of expenditure.
 - Water in reservoirs and the municipal pipe system was not valued or accounted for in the annual financial statements. In the absence of a proper system to account for inventory and stock records accounting for the water, I was unable to quantify the extent of the misstatement. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and completeness of inventory.

Cash flow statement

27. I was unable to obtain sufficient appropriate audit evidence to determine whether the cash flow statement and the related notes were fairly stated. Taking into account the misstatements and scope limitations identified in the annual 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 disclosure of the cash flow statement and related notes.

Consumer deposits

28. I was unable to confirm that management has properly charged and accounted for all consumer deposits. Consequently, I was unable to obtain sufficient appropriate audit assurance as to the completeness and valuation of consumer deposits of R969 026, as disclosed in the statement of financial position, and the related disclosure in note 11 to the annual financial statements. The municipality's records and information available did not permit the application of alternative audit procedures regarding employee-related costs.

Unauthorised expenditure

29. There was no proper system in place to account for and identify unauthorised expenditure and there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all unauthorised expenditure was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of unauthorised expenditure of R0 (2010: R653 490), as disclosed in note 31 to the annual financial statements.

Irregular expenditure

30. I could not be provided with sufficient appropriate audit evidence that management has properly identified, investigated and recorded all irregular expenditure transactions. Due to the limitations placed on my audit of expenditure and procurement management at the municipality, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of irregular expenditure of R0 (2010: R56 404 768), as disclosed in note 31 to the annual financial statements.

Fruitless and wasteful expenditure

31. I could not be provided with sufficient appropriate audit evidence that management has properly identified, investigated and recorded all fruitless and wasteful expenditure transactions. Due to the limitations placed on the scope of the work performed relating to expenditure, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of fruitless and wasteful expenditure of R0 (2010: R2 952 700), as disclosed in note 31 to the annual financial statements.

Commitments

32. Sufficient appropriate audit evidence as to the completeness, valuation, allocation and existence of as well as the municipality's obligations to commitments disclosed as R70 983 977 (2010: R73 711 465) in note 35 to annual financial statements could not be obtained due to the lack of a proper contract management system for the identification and recognition of contracts, a complete contract register or any other documents to enable me to quantify the capital commitments. The municipality's records and information available did not permit the application of alternative procedures regarding commitments.

Contingent liabilities

33. Legal confirmations regarding pending claims were requested, but could not be obtained from two lawyers that are involved in a number of cases on behalf of the municipality. Since the municipality's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the completeness, valuation and allocation of pending claims amounting to R881 909 included in contingent liabilities of R4 845 701, as disclosed in note 33 to the annual financial statements.
34. Section 125(2)(c) of the MFMA states that the notes to the annual financial statements of a municipality must include particulars of any contingent liabilities of the municipality as at the end of the financial year. Contingent liabilities amounting to R228 177 (2010: R2 709 742) were identified, which were not disclosed in note 33 to the annual financial statements. Contingent liabilities were therefore understated with R228 177 (2010: R2 709 742).

Distribution losses

35. Section 125(2)(d)(i) of the MFMA requires that the annual financial statements of a municipality must disclose particulars of any material losses. No distribution losses were disclosed in the notes to the annual financial statements due to the municipality not implementing adequate control measures to reliably calculate these losses. In the absence of sufficient appropriate documents, I was unable to determine the extent of the understatement in distribution losses.

Related parties

36. International Public Sector Accounting Standard, IPSAS 20, *Related-party disclosures*, requires the disclosure of related party relationships where control exists, and any related party transactions that occurred during the year. Undisclosed related party transactions amounting to R334 333 were identified. No disclosure with regard to these transactions has been made in the annual financial statements.

Financial instruments

37. The SA Statements of GAAP, IFRS 7 (AC144), *Financial instrument: Disclosures*, requires the disclosure of information on liquidity risks, maturity analysis, sensitivity analysis and credit risk exposure relating to financial instruments. Contrary to the minimum disclosure requirements, the municipality's exposure to financial risk and how these risks were mitigated were not disclosed in the annual financial statements.

Other statutory disclosure

38. Sections 125(1)(b) and (c) and section 125(2)(e) of the MFMA state that the notes to the annual financial statements of a municipality must include the total amounts paid in contributions to organised local government, audit fees, taxes, levies, duties as well as pension and medical aid contributions, whether any amounts were outstanding as at the end of the financial year and all areas of non-compliance with the MFMA. In contravention with this section, various differences were noted between the amounts, as disclosed in note 32 to the annual financial statements and the supporting schedules.
39. Particulars of non-compliance with the MFMA were not disclosed in the notes to the annual financial statements, as required by section 125(2)(e) of the MFMA. As included in paragraphs 51 to 95 of this report, several material deviations from the MFMA were identified during the audit; however, no particulars of any of these matters were disclosed in the notes to the annual financial statements.

Disclosures

40. The prior period errors were not disclosed as required by paragraph 49 of SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors*. The following details should have been disclosed:
- The nature of the prior period error
 - For each prior period presented the amount of the correction for each financial statement line item affected
 - The amount of the correction at the beginning of the earliest prior period presented
41. The nature of the changes in accounting policies, descriptions of the transitional provisions, the amounts of the adjustments for each financial statement line item affected and the amounts of the adjustments relating to periods before those presented were not adequately disclosed in the annual financial statements, as required by paragraph 28 of SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors*.
42. The municipality did not sell prepaid electricity for the year under review, an accounting policy was however included in the annual financial statements.

Financial sustainability

43. 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 annual financial statements. The difficulties being experienced by the municipality in recovering its consumer debtors, the potential negative effect of this tendency on the cash flow 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 annual financial statements did not disclose any details of the uncertainty as per note 1.4 to the annual financial statements and have been prepared on a going concern basis. The municipality's accounting records did not provide sufficient appropriate audit evidence that the municipality is able to continue as a going concern.

Disclaimer of opinion

44. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these annual financial statements.

Emphasis of matter

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

Restatement of corresponding figures

46. As disclosed in note 30 to the annual financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 30 June 2011 in the annual financial statements of the municipality at, and for the year ended, 30 June 2010.

Additional matters

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

Material inconsistencies in other information included in the annual report

48. 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.

Unaudited supplementary schedules

49. The municipality provided supplementary information in the annual financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with SA Standards of GRAP, GRAP 1, *Presentation of financial statements*. The supplementary information set out on pages xx to xx does not form part of the annual financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Predetermined objectives

50. I was unable to conduct the audit of performance against predetermined objectives as the municipality did not submit the annual performance report as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and section 121(3)(c) of the MFMA.

Compliance with laws and regulations

Strategic planning and performance management

51. The accounting officer of the municipality did not, by 25 January, assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA.

Budgets

52. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
53. The mayor did not submit all quarterly reports to the council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
54. The accounting officer did not always submit the monthly budget statements to the mayor and the relevant provincial treasury, as required by section 71(1) of the MFMA.

Annual financial statements, performance and annual reports

55. The accounting officer did not submit the annual financial statements of the municipality for auditing, within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.
56. The performance report for the financial year under review was not prepared, as required by section 46 of the MSA and section 121(3)(c) of the MFMA.
57. The mayor did not table, in council, the 2009-10 annual report of the municipality within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
58. The mayor did not submit a written explanation to the council setting out the reasons for the delay in the tabling of the 2009-10 annual report in council, as required by section 127(3) of the MFMA.

Audit committee

59. No audit committee was in place, as required by section 166(1) of the MFMA.
60. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

Internal audit

61. The municipality did not have an internal audit unit in place, as required by section 165(1) of the MFMA.

Procurement and contract management

62. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as per the requirements of Supply Chain Management (SCM) regulations 17(a) and (c).
63. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of between R10 000 and R200 000 were procured by means of obtaining written price quotations from at least three different prospective providers, as per the requirements of SCM regulations 17(a) and (c).
64. Quotations were accepted from prospective providers who are not on the list of 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).
65. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids, as per the requirements of SCM regulations 19(a) and 36(1).
66. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of days, as per the requirements of SCM regulations 22(1) and 22(2).
67. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by the 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 per the requirements of SCM regulation 28(2).
68. Sufficient appropriate audit evidence could not be obtained that final awards and recommendation of awards to the accounting officer were made by an adjudication committee constituted as per the requirements SCM regulation 29(2).
69. Sufficient appropriate audit evidence could not be obtained that awards were made to providers whose tax matters have been declared by the South African Revenue Services to be in order, as required by SCM regulation 43.
70. Awards were made to suppliers who did not submit a declaration on their employment by the state or their relationship to a person employed by the state, as per the requirements of Municipal SCM regulation 13(c).
71. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB).
72. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers that scored the highest points in the evaluation process, as per the requirements of section 2(1)(f) of Preferential Procurement Policy Framework Act, 2000 (Act No.5 of 2000) (PPPFA).
73. The performance of contractors or providers were not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
74. The municipality did not implement a SCM policy, as required by section 111 of the MFMA.
75. The prospective providers list for procuring goods and services through quotations was not updated at least quarterly to include new suppliers that qualify for listing and prospective providers were not invited to apply for such listing at least once a year, as per the requirements of SCM regulations 14(1)(a)(ii) and 14(2).
76. Contracts were extended or modified to the extent that competitive bidding processes were being circumvented contrary to the requirement of a fair SCM system in section 112 of the MFMA.
77. Contracts were extended or modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.

78. Sufficient appropriate audit evidence could not be obtained that contracts and quotations to the value of R26 620 304 were procured in accordance with legislative requirements and the SCM policy.
79. Sufficient appropriate audit evidence could not be obtained that awards were made to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the PPPFA and its regulations.
80. 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 PPPFA and SCM regulation 28(1)(a).
81. Sufficient appropriate audit evidence could not be obtained that awards were given to providers based on criteria that were similar to those stipulated in the original bid documents and were stipulated in the original bid documents as per the requirements of SCM regulations 21(b) and 28(1).
82. 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).
83. The contract performance measures and methods whereby they are monitored were insufficient to ensure effective contract management, as per the requirements of section 116(2)(c) of the MFMA.

Human resource management

84. Senior managers directly accountable to the municipal manager did not sign annual performance agreements for the year under review, as required by sections 57(1)(b) and 57(2)(a) of the MSA.
85. The municipal manager did not sign an annual performance agreement for the year under review, as required by sections 57(1) (b) and 57(2) (a) of the MSA.

Expenditure management

86. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
87. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised expenditure when it was incurred, accounted for creditors of the municipality and accounted for payments made by the municipality, as required by section 65(2)(b) of the MFMA.
88. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
89. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.

Conditional grants

90. The accounting officer did not evaluate the performance of the municipality in respect of programmes funded or partially funded by a schedule 4 allocation within two months after the end of the financial year, as required by section 11(6) of DoRA.

Revenue management

91. Interest was not charged on all arrear accounts, as required by section 64(2)(g) of the MFMA.
92. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.
93. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which recognised revenue when it is earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.

Asset management

94. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality, as required by section 63(2)(a) of the MFMA.
95. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register), as required by section 63(2)(c) of the MFMA.

INTERNAL CONTROL

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

• Leadership

The leadership did not 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.

The leadership did not take timeous and adequate action to address weaknesses at the finance and SCM directorate, which resulted in non-compliance with applicable legislation and gave rise to irregular expenditure.

The leadership did not sufficiently monitor the recording and reconciliation of the financial records. Sufficient control measures were not developed by the leadership to address the qualifications reported in the prior years.

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

Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented.

Inadequate filing procedures at the municipality resulted in supporting documentation that was not available for audit purposes. As a result, significant difficulties were experienced in respect of the availability of information.

The annual financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure.

- **Governance**

The annual 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.

The municipality did not have a documented fraud prevention plan. Internal control deficiencies were not identified and communicated in a timely manner to allow for corrective action to be taken. The implementation of external audit recommendations was not monitored. This resulted in the prior year audit findings not being substantially addressed.

The audit committee, internal audit unit and performance audit committee were not in place for the financial year.

Auditor-General

Bloemfontein

31 January 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence