

REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE MALUTI-A-PHOFUNG LOCAL MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

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

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards on Generally Recognised Accounting Practice (SA Standards of GRAP), 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, 2011 (Act No. 6 of 2011) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate 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 consolidated and separate 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 regarding property, plant and equipment in the consolidated financial statements amounting to R3 906 631 661 (2011: R4 543 342 605) as well as depreciation amounting to R311 276 064, as set out in notes 5 and 45, respectively, to the consolidated and separate financial statements. This was because the municipality did not compile a complete and accurate asset register for the year under review. I was unable to confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustment relating to property, plant and equipment in the consolidated and separate financial statements was necessary.

Payables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence regarding the payables from exchange transactions, as set out in the statement of financial position and note 23 to the consolidated and separate financial statements to the amount of R238 972 038 (2011: R200 892 392). This was because the municipality did not keep proper records for payables from exchange transactions. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to payables from exchange transactions in the consolidated and separate financial statements was necessary.

Service charges

6. I was unable to obtain sufficient appropriate audit evidence regarding service charges in the statement of financial performance and note 30 to the consolidated and separate financial statements to the amount of R330 555 183 (2011: R215 053 133). This was because the municipality did not keep proper record of distribution losses and supporting documentation relating to service charges and did not ensure the accuracy of meter readings captured on the system. The entity, furthermore, accounted for income on the cash basis of accounting and not the accrual basis of accounting. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to service charges in the consolidated and separate financial statements was necessary.

Expenditure

7. The entity recognised expenses when the expense was paid and not when the expense was incurred, as required by SA GRAP1, *Presentation of financial statements*. Consequently, expenditure as disclosed in the statement of financial performance is understated by an unknown amount.

Personnel cost

8. I was unable to obtain sufficient appropriate audit evidence regarding the accuracy and occurrence of personnel cost in the statement of financial performance and note 39 to the consolidated and separate financial statements to the amount of R235 717 513. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to personnel cost in the consolidated and separate financial statements was necessary.

Community project expenditure

9. I was unable to obtain sufficient appropriate audit evidence as to the occurrence and accuracy of community project expenditure in the statement of financial performance and note 41 to the consolidated financial statements amounting to R104 648 939 (2011: R33 731 241). I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to community project expenditure in the consolidated financial statements was necessary.

Investment property

10. I was unable to obtain sufficient appropriate audit evidence regarding investment property amounting to R26 402 452 (2011: R27 705 697) as set out in note 6 to the consolidated and separate financial statements because the fixed asset register did not include erf numbers in order to identify investment properties. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to investment property in the consolidated and separate financial statements was necessary.

Property rates

11. I was unable to obtain sufficient appropriate audit evidence regarding property rates to the amount of R172 028 030 (2011: R132 112 110) in the statement of financial performance and note 29 to the consolidated and separate financial statements. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to property rates for the current financial year and accumulated surplus, as well as the prior period property rates in the consolidated and separate financial statements, was necessary.

Interest received

12. The prior year figure for interest received as set out in note 34 to the consolidated and separate financial statements was understated by R14 770 844. The municipality, however, only corrected the prior figure with R5 916 736, resulting in an understatement of trade receivable from exchange transactions as per note 16 to the consolidated and separate financial statements and interest received as per note 34 to the consolidated and separate financial statements by R8 854 108. Consequently, the corresponding figure for trade receivable from exchange transactions as per note 16 to the consolidated and separate financial statements and accumulated surplus was not restated to include the understatement of R8 854 108.

Repairs and maintenance

13. The municipality did not review the accuracy of data captured on the system on a regular basis and as a result assets amounting to R9 232 216 (2011: 2 401 283) were included under repairs and maintenance as per the statement of financial performance and note 46 to the consolidated and separate financial statements. Consequently, property, plant and equipment as set out in note 5 to the consolidated and separate financial statements are understated by R9 232 216 and repairs and maintenance are overstated by the same amount.

Inventory

14. I was unable to obtain sufficient appropriate audit evidence to confirm valuation of water inventory as set out in note 12 to the consolidated and separate financial statements to the amount of R5 554 277 (2011: R4 451 084) because the municipality did not value water inventory at year-end. I was unable to confirm the water inventory by alternative means.

Consequently, I was unable to determine whether any adjustment relating to water inventory in the consolidated and separate financial statements was necessary.

Value-added tax (VAT)

15. I was unable to obtain sufficient appropriate audit evidence regarding VAT receivable in the statement of financial position and note 15 to the consolidated and separate financial statements to the amount of R7 454 469 (2011: R3 278 368). I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustment relating to VAT receivable in the consolidated and separate financial statements was necessary.

Unauthorised expenditure

16. The municipality did not manage their expenditure against the budgeted amounts. The municipality exceeded its budgeted expenditure by R29 605 589 (2011: R165 162 000) during the year under review. Consequently, unauthorised expenditure is understated by this amount.

Irregular expenditure

17. The municipality incurred irregular expenditure of R7 247 237 during the year under review, which was not included in note 61 to the consolidated and separate financial statements. This was mainly due to non-compliance with supply chain management (SCM) requirements.

Capital commitments

18. The municipality did not have any internal controls or policies in place for capital commitments and I was unable to obtain sufficient appropriate audit evidence to confirm the completeness and valuation of capital commitments. Consequently, I was unable to determine whether any adjustment relating to capital commitments in the consolidated and separate financial statements was necessary.

Events after reporting date

19. The municipality did not have sufficient policies and procedures in place to identify subsequent events as required by SA Standards of GRAP, GRAP 14, *Events after reporting date*. Consequently, I could not determine whether any adjustments were required to the amount disclosed as events after reporting date.

Contingent liabilities

20. I was unable to obtain sufficient appropriate audit evidence regarding the valuation and completeness of contingent liabilities amounting to R77 170 482 as set out in note 54 to the consolidated and separate financial statements. I was unable to confirm the amount by alternative means. Consequently, I was unable to determine whether any adjustments relating to contingent liabilities in the disclosures to the consolidated and separate financial statements were necessary.

Presentation of budgeted information

21. I was unable to obtain sufficient appropriate audit evidence regarding the presentation of budget information as set out in note 62 to the consolidated and separate financial statements. I was unable to confirm the budget disclosures by alternative means. Consequently, I was unable to confirm the accuracy of this disclosure note.

Cash flow statement

22. I was unable to obtain sufficient appropriate audit evidence to determine whether the consolidated and separate 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 consolidated and separate 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 confirm the accuracy, completeness and correct disclosure of the cash flow statement and related notes.

Accumulated surplus

23. I was unable to obtain sufficient appropriate audit evidence of the accumulated surplus amounting to R3 804 383 551(2011: R4 549 086 159) as disclosed in the statement of financial position and the statement of changes in net assets due to the significance of the misstatements and scope limitation identified in the consolidated and separate financial statements, as set out in this report. The municipality's records and information available did not permit the application of alternative procedures. Consequently, I was unable to determine whether any further adjustments to the amount disclosed for accumulated surplus were necessary.

Financial sustainability

24. 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 the consolidated and separate financial statements. The difficulties experienced by the municipality to recover their 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 is exposed to serious financial difficulties in terms of section 138 of the MFMA. The municipality did not disclose any details of the uncertainty as per note 1.3 and note 59 to the consolidated and separate financial statements which have been prepared on the 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.

Financial systems conversion

25. The entity migrated to a new financial system during the year under review. Sufficient, appropriate audit evidence could not be provided for audit purposes to ensure the accuracy and completeness of the balances taken over to the new system. The accuracy and completeness of financial data supporting the financial statements could consequently not be determined.

Comparative figures

26. I was unable to obtain sufficient appropriate audit evidence regarding restatement of comparative figures amounting to R108 502 701 to the consolidated and separate financial statements. These amendments were, furthermore, not disclosed in note 56 to the financial statements. I was unable to confirm the comparative figures by alternative means. Consequently, I was unable to determine whether any adjustment relating to the prior period error disclosure note was necessary.

Disclaimer of opinion

27. 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 financial statements.

Emphasis of matters

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

Significant uncertainties

29. With reference to note 54 to the consolidated and separate financial statements, contingent liabilities, the municipality is the defendant in a number of possible claims. The ultimate outcome of these matters cannot presently be determined. A provision for any liability that may result from these contingent liabilities has not been made in the consolidated and separate financial statements.

Restatement of corresponding figures

30. As disclosed in notes 56 and 57 to the consolidated and separate financial statements, the corresponding figures for 30 June 2011 have been restated because of errors identified during the year ended 30 June 2012 in the consolidated financial statements of the Maluti-A-Phofung local municipality at, and for the year ended, 30 June 2011.

Material impairments

31. As disclosed in note 42 to the consolidated financial statements, material losses to the amount of R96 509 285 were incurred as a result of the write-off of irrecoverable trade debtors.

Additional matters

32. 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

33. I have not obtained the annual report and as a result have not been able to conclude on the consistency between the consolidated financial statements and other information included in the annual report.

Unaudited supplementary schedules

34. The supplementary information set out on pages xx to xx does not form part of the consolidated financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

Supplementary explanations of variances presented outside the consolidated financial statements

35. The supplementary explanations of the budget variances contained in appendix G do not form part of the consolidated financial statements. I have not audited these explanations and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

36. 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

37. The annual performance report included in the annual report was not presented in time for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.
38. The information was assessed to determine whether performance 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).
39. The material findings are as follows:

Usefulness of information

Presentation

40. Improvement measures in the annual performance report for a total of 60% of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures for processes pertaining to the reporting of performance information.

Consistency

41. The MSA, section 41(c), requires that the integrated development plan (IDP) should form the basis for annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 30% of the reported objectives are not consistent with the objectives in the IDP or are not included in the approved IDP. This is due to a lack of proper monitoring and review of the performance objectives included in the annual report.

Measurability

42. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. All (100%) of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
43. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. All (100%) of the measures relevant to all objectives were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual predetermined objectives.

Compliance with laws and regulations

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

Strategic planning and performance management

45. The municipality did not afford the local community at least 21 days to comment on the final draft of its IDP before the plan was submitted to council for adoption, as required by regulation 15(3) of the municipal planning and performance management (MPPM) regulations.
46. Sufficient appropriate audit evidence was not submitted to confirm that the municipality had given effect to its IDP and conducted its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA and MPPM regulation 6.
47. Sufficient appropriate audit evidence could not be obtained to verify whether the local community was consulted in the drafting and implementation of the IDP, as required by section 28 of the MSA and MPPM regulation 15(1)(a)(i).
48. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
49. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
50. The municipality did not
- monitor performance with regard to each of those development priorities and objectives and against the key performance indicators and targets set;
 - measure and review performance at least once per year with regard to each of those development priorities and objectives and against the key performance indicators and targets set; and
 - take steps to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41 of the MSA.

Budget

51. Expenditure was incurred that was not budgeted for, in contravention of section 15 of the MFMA.

Annual consolidated financial statements, performance and annual reports

52. The consolidated and separate financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of investments, cash and bank, property, plant and equipment, investment property, expenditure, commitments and material losses identified by the auditors in the submitted consolidated financial statements were subsequently corrected, but the uncorrected material misstatements and remaining supporting records that could not be provided resulted in the consolidated financial statements receiving a disclaimed audit opinion.
53. Sufficient appropriate audit evidence could not be obtained that the draft annual report for the year under review complies with section 121(3)(a) and 121(4)(a) of MFMA, due to the fact that the draft annual report was not submitted for an audit.

Internal audit

54. The internal audit unit did not report to the audit committee on matters relating to compliance with the MFMA, DoRA and other applicable legislation, as required by section 165(2)(b) of the MFMA.
55. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and MPPM regulation 14(1)(a).
56. The internal audit unit did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee, as required by MPPM regulation 14(1)(c).

Audit committee

57. A performance audit committee was not in place and the audit committee established in terms of the MFMA section 166(1) was not used for this function, as required by MPPM regulation 14(2)(a).
58. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA, DoRA and other applicable legislation, as required by section 166(2)(b) of the MFMA.

Conditional grants

59. Sufficient appropriate audit evidence could not be obtained that the accounting officer had evaluated 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.
60. Sufficient appropriate audit evidence could not be obtained that the municipality had submitted quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of DoRA.
61. Sufficient appropriate audit evidence could not be obtained that the municipality had evaluated its performance in respect of programmes funded by the allocation and/or submitted the evaluation to the transferring national officer within two months after the end of the financial year, as required by section 12(6) of DoRA.
62. Sufficient appropriate audit evidence could not be obtained that the allocation(s) were utilised for the purposes stipulated in the grant framework, in contravention of section 15(1) of DoRA.
63. Sufficient appropriate audit evidence could not be obtained that unspent conditional grant funds not committed to identifiable projects or not approved by the National Treasury for retention were surrendered to the National Revenue Fund, as required by section 20(1) of DoRA.

Expenditure management

64. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
65. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for payments made, as required by section 65(2)(b) of the MFMA.
66. 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.
67. Unauthorised, irregular and fruitless and wasteful expenditure was not investigated and as a result it was not recovered from the liable person, as required by section 32(2) of the MFMA.

Human resource management and compensation

68. Sufficient appropriate audit evidence could not be obtained that appointments were only made in posts which were provided for on the approved staff establishment of the municipality, as required by section 66(3) of the MSA.
69. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.

70. Sufficient appropriate audit evidence could not be obtained that an acting municipal manager was not appointed for a period exceeding three months, as required by section 54A (2A)(a) of the MSA.
71. The performance of personnel was not effectively monitored, as required by section 39(a), (b) and 40 of the MSA.

Revenue

72. An adequate management, accounting and information system and the related internal controls were not in place which recognised revenue when it was earned, accounted for debtors and accounted for receipts of revenue, as required by section 64(2)(e) of the MFMA.
73. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.

Asset management

74. Sufficient appropriate audit evidence was not submitted to confirm that an adequate management, accounting and information system, which accounts for assets, was in place, as required by section 63(2)(a) of the MFMA.
75. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

76. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
77. Sufficient appropriate audit evidence could not be obtained that all contracts were awarded and quotations were accepted in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as all required information could not be provided for audit.

Internal control

78. I considered internal control relevant to my audit of the consolidated financial statements, performance report 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 performance report and the findings on compliance with laws and regulations included in this report.

Leadership

79. The chief executive officer position of the entity was vacant for the year under review.
80. Leadership did not evaluate to determine 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.
81. Leadership did not take timeous and adequate action to address weaknesses in the finance and SCM directorate, which resulted in non-compliance with the applicable legislation and gave rise to fruitless and wasteful and irregular expenditure.
82. Leadership of the municipality did not ensure that internal control procedures were developed, implemented and monitored to ensure that daily disciplines were performed and reviewed.
83. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evidenced by the failure of management to adequately address the external audit findings in a timely manner. The municipality failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause. This resulted in the audit findings of the prior year report recurring in the current year.
84. 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

85. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented.
86. Inadequate filing procedures at the entity resulted in limitations of scope during the current and previous year's audits. As a result significant difficulties were experienced in respect of the availability of information.
87. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect disclosure.
88. The municipality did not have the capacity to address backlog issues and financial system problems, resulting in the need to appoint consultants. Consultants assisted with the preparation of an asset register and financial statements.
89. Finance staff had an insufficient understanding of the accounting framework. This contributed to the numerous qualifications in the financial statements of the municipality.

Governance

90. The risk of material misstatement due to fraud was not considered. Sufficient controls and segregation of duties to prevent or detect fraudulent data and asset misappropriation were not implemented and maintained.

91. The consolidated financial statements were subject to material corrections resulting from the audit, which can be attributed to the lack of risk assessments, weaknesses in the design and implementation of internal control in respect of financial management and financial reporting and weaknesses in the information systems.
92. The accounting officer did not prioritise the establishment of a fully functioning performance audit committee and therefore the functions were not established and operational during the financial year. This also resulted in the committee not being able to fulfil all their responsibilities.
93. The accounting officer did not ensure that internal audit followed a risk-based audit approach and submitted quarterly reports on financial, predetermined objectives and compliance matters.

Auditor-General

Bloemfontein

31 January 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence