

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF MOQHAKA 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 Moqhaka Local Municipality which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets 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 and fair presentation of these financial statements in accordance with the Statements of Generally Recognised Accounting Practice (Statements of GRAP) 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.
4. Paragraph 11 et seq. of the Statement of GRAP, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Moqhaka Local Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

**Basis for disclaimer of opinion**

**Property, plant and equipment**

5. I was unable to obtain sufficient appropriate audit evidence to conclude on the completeness, existence and valuation of and the rights to ownership of property, plant and equipment amounting to R1 085 368 102 (2008: R1 126 563 540), as disclosed in note 1 to the financial statements, due to the following:
  - a) Management undertook a comprehensive process to establish a complete and reliable fixed asset register for the municipality and consequently the fixed asset register of the municipality was completely reconstructed during the current financial year. This register was used as a basis for the preparation of the financial statements as the process, which included the identification and valuation of assets that had not previously been included in the financial statements, was substantially completed for property, plant and equipment disclosure purposes. Corrections were made retrospectively and therefore the comparative

information, as disclosed in note 1 to the financial statements, was restated. The detailed valuation calculations and assumptions used to value the assets could not be obtained for audit purposes. As a result of the lack of sufficient appropriate audit evidence relating to the measurement of the property, plant and equipment I was unable to consider reasonable alternative procedures.

- b) I was unable to obtain audit assurance as to the existence and the rights to ownership of property, plant and equipment amounting to R22 445 307 due to unique identification not being allocated to asset components in the asset register and the required title deeds that could not be obtained. Consequently, these assets could not be identified during the physical verification. In the absence of unique asset identification alternative audit procedures could not be performed.
- c) Paragraph 21 of the Statement of Generally Recognised Accounting Practise, GRAP 17: *Property, plant and equipment* (GRAP 17) states that an item of property, plant and equipment that qualifies for recognition as an asset shall be measured at cost. Sufficient appropriate audit evidence could not be obtained and alternative procedures could not be performed for the prior period error disclosed in note 29.16 to the financial statements relating to fixed asset additions recognised in the incorrect financial year amounting to R8 427 919. Furthermore, these assets could not be traced to the fixed asset register and I was unable to determine whether these additions were procured in terms of the municipality's supply chain management policy as the required supporting documentation could not be obtained.
- d) Paragraph 58 of GRAP 17 states that the depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset. The total depreciation charge with regard to property, plant and equipment, intangible assets and investment property amounting to R989 281 as per the statement of financial performance for the previous year do not agree with the depreciation charge in the corresponding notes 1, 2 and 3 to the financial statements, which have a combined total of R42 995 282. The depreciation charge for property, plant and equipment, intangible assets and investment property corresponds to the fixed asset register reconstructed in the current financial year. I was unable to determine the extent to which the depreciation charge as disclosed in the notes was not considered in determining the value of depreciation recognised in the statement of financial performance. Consequently, depreciation for the previous year, as disclosed in the statement of financial performance and accumulated surplus for the previous year, is understated and the surplus for the previous year overstated by R42 006 001.
- e) In terms of paragraph 11(a) and (b) of GRAP 17, the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the entity, and the cost or fair value of the item can be measured reliably. Contrary to the prescribed accounting treatment, the management of Moqhaka Local Municipality did not recognise Municipal Infrastructure Grant (MIG) costs relating to assets under construction as property, plant and equipment. These costs were recognised as expenditure and the projects were only recognised as property, plant and equipment once the projects had been finalised. The municipality's records did not permit me to determine to what extent the property, plant and equipment is understated.
- f) Paragraph 53 of GRAP 17 states that 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 shall be depreciated separately. With the reconstruction of the fixed asset register, land was included in infrastructure, community and other assets, as disclosed in note 1 to the financial statements, and was not accounted for separately. Consequently, the land was erroneously depreciated. Due to land not being separated in the fixed asset register, it was impracticable to split the value of land to determine to what extent depreciation and accumulated depreciation are overstated.

- g) Paragraph 65 of GRAP 17 states that depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. With the reconstruction of the fixed asset register, erroneous acquisition dates were captured. As a result, depreciation was incorrectly calculated on items of land and buildings, community assets and investment property, as disclosed in notes 1 and 3 to the financial statements. Had depreciation been adequately provided, the surplus for the year would have increased by R16 907 (2008: R16 323), property, plant and equipment would have been reduced by an accumulated depreciation of R761 404 (2008: R778 311) and accumulated surplus would have been increased by R16 907 (2008: R16 323).

### Receivables

6. Based on the audit findings below, I was unable to obtain sufficient appropriate audit evidence as to the existence, valuation and completeness of consumer receivables from exchange transactions amounting to R86 312 896 (2008: R74 163 030); other receivables from exchange transactions amounting to R2 415 043 (2008: R12 160 384); and other receivables from non-exchange transactions amounting to R26 443 (2008: R1 754 418), as disclosed in notes 7, 8 and 9 respectively, could not be obtained due to the following:
- a) Sufficient appropriate audit evidence could not be obtained regarding the valuation of consumer receivables and government subsidies amounting to R1 120 290 (2008: R6 678) and R26 443 (2008: R1 754 418), as presented in notes 7 and 9 to the financial statements respectively. In addition, sufficient appropriate audit evidence could not be obtained for other receivables amounting to R2 268 851 for the previous year, as disclosed in note 8 to the financial statements. In the absence of sufficient appropriate audit evidence, the municipality's records did not permit the application of alternative procedures. This matter was also reported in the previous year.
- b) Payments received in advance, as disclosed in note 16 to the financial statements, consumer receivables and other receivables exceeded the debtor age analysis by R1 056 233 in the previous year. Sufficient appropriate audit evidence could not be obtained for this difference and the municipality's records did not permit the application of alternative procedures. This matter was also reported in the previous year.
- c) Sufficient appropriate audit evidence could not be obtained for VAT included in the provision for bad debts amounting to R3 617 796, as disclosed in note 7 to the financial statements. I was also unable to perform alternative procedures.
7. Consumer receivables from exchange transactions amounting to R86 312 896 (2008: R74 163 030); other receivables from exchange transactions amounting to R2 415 043 (2008: R12 160 384); and other receivables from non-exchange transactions amounting to R26 443 (2008: R1 754 418), as disclosed in notes 7, 8 and 9 respectively, were not accurately valued and completely accounted for due to the following inconsistencies identified:
- a) Paragraph 63 of South African Statement of Generally Accepted Accounting Practice (SA Statements of GAAP), IAS 39 (AC 133): *Financial Instruments: Recognition and Measurement* states that if there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. In calculating the contribution to the current year's provision for bad debts, the VAT was taken into consideration and the output tax was decreased accordingly. However, VAT was not considered in calculating the provision for bad debts for the previous year amounting to R89 198 254, as disclosed in note 7 to the financial statements. Consequently, the current year's accounting treatment is not consistent with that applied in the previous year. As sufficient appropriate audit evidence could not be presented and the

municipality's records did not permit the application of alternative procedures, I was further unable to determine the extent of overstatement in respect of VAT payable for the previous year, as disclosed in note 18 to the financial statements, and bad debts for the previous year, according to the statement of financial performance.

- b) Suspense accounts were not cleared regularly and before the preparation of the financial statements. Consequently, unallocated amounts amounting to R480 308 (2008: R2 695 081) were disclosed as other receivables from exchange transactions in note 8 to the financial statements. I was unable to confirm the total extent of income, expenditure, assets or liabilities that might be included in these amounts as sufficient appropriate audit evidence could not be presented and alternative procedures could not be performed.
- c) Paragraph 11 (a) and (b) of GRAP 17, states that the cost of an item of property, plant and equipment shall be recognised as an asset if it is probable that future economic benefits or service potential associated with the item will flow to the entity, and the cost or fair value of the item can be measured reliably. Items of property, plant and equipment amounting to R1 424 737 are incorrectly included in unallocated amounts as presented in note 8 to the financial statements and therefore results in an overstatement of other receivables from exchange transactions. These items could not be traced to the fixed asset register as the supporting documentation could not be aligned with assets in the register. Since the asset register was reconstructed and comparative information restated, I could not determine whether this matter results in an understatement of property, plant and equipment or an overstatement of accumulated surplus.

#### **Payables**

- 8. Sufficient appropriate audit evidence could not be presented for payments received in advance amounting to R1 289 176 (2008: R6 559 627) and the accounting system of the municipality did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence and valuation of payments received in advance amounting to R9 240 873 (2008: R15 275 477), as disclosed in note 16 to the financial statements.
- 9. Sufficient appropriate audit evidence could not be presented for the accumulated leave provision amounting to R738 743 (2008: R1 718 857). In a number of instances annual leave was approved after it had been taken. Certain leave records could not be presented and the municipality did not have adequate leave registers and therefore alternative procedures could not be performed. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence and valuation of staff leave payable as disclosed in note 16 to the financial statements.
- 10. Included in payments received in advance are deposits amounting to R827 945 which had not been allocated to debtors accounts at year-end. Consequently, payments received in advance, as disclosed in note 16 to the financial statements, are overstated and consumer receivables from exchange transactions, as disclosed in note 7 to the financial statements, are understated by this amount.

#### **Prior period errors**

- 11. Paragraph 49(b) of Statement of GRAP, GRAP 3: *Accounting policies, changes in accounting estimates and errors* states that an entity shall disclose for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected. Property, plant and equipment, intangible assets and investment property, as disclosed in notes 1, 2 and 3 to the financial statements respectively, were restated with a total amount of R628 451 737. However, the prior period errors disclosed in note 29 to the financial statements, relating to these balances, only

amount to R609 429 899. Therefore, prior period errors amounting to R19 021 838 were not disclosed in the financial statements.

#### **Unauthorised expenditure**

12. Section 1 of the MFMA defines unauthorised expenditure as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3) of the act, and includes overspending of the total amount appropriated in the municipality's approved budget. As disclosed in note 40 to the financial statements, unauthorised expenditure of R75 859 183 (2008: R3 663 520) was incurred due to overspending of the total amount appropriated in the municipality's approved budget. However, unauthorised expenditure relating to the previous year, as disclosed in note 40 to the financial statements, is understated due to prior period errors not being taken into consideration when this amount was determined. Consequently, unauthorised expenditure in the prior year is understated by R11 303 963.

#### **Expenditure**

13. Paragraph 6 of Statement of GRAP, GRAP 1: *Presentation of financial statements* defines the accrual basis as a basis of accounting under which transactions and other events are recognised when they occur. In an attempt to reallocate additions (refer to par. 4(c)) between the current and previous year, repairs and maintenance expenditure amounting to R8 427 919, as disclosed in the statement of financial performance, was erroneously reallocated from the previous year to the current year. Repairs and maintenance is therefore understated by R8 427 919 in the previous year and overstated by this amount in the current year.

#### **Employee-related costs**

14. No employment contracts or appointment letters could be obtained for employee-related costs amounting to R5 978 764 in the current year. In the absence of sufficient appropriate audit evidence, the municipality's records did not permit the application of alternative procedures and therefore no assurance could be obtained that these costs had actually occurred and were accurately recorded. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the accuracy, completeness and occurrence of employee-related costs.

#### **Value-added tax**

15. An amount of R4 005 583 was claimed in the financial year ended 30 June 2007 pertaining to input tax not claimed in the previous periods. The accuracy and completeness of this amount could not be confirmed. Consequently, audit assurance as to the existence, valuation and completeness of VAT receivable amounting to R10 216 991 in the current year and VAT payable amounting to R9 893 260 in the previous year, as disclosed in note 18 to the financial statements, could not be obtained and the municipality's records did not permit the application of alternative procedures.

#### **Unspent conditional grants and receipts**

16. Sufficient appropriate audit evidence could not be obtained for the correction of the balance of unspent municipal infrastructure grant at the beginning of the previous year amounting to R2 780 761, as disclosed in note 22.5 to the financial statements, and the related prior period error amounting to R3 634 197, as disclosed in note 29.19 to the financial statements. In the absence of sufficient appropriate audit evidence, the municipality's records did not permit the application of alternative procedures. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence, valuation and completeness of unspent conditional grants and the accuracy of the prior period error.

### **Irregular expenditure**

17. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality that is not in accordance with a requirement of this act, and which has not been condoned in terms of section 170. As disclosed in note 38 to the financial statements, irregular expenditure of R20 072 972 (2008: R6 840 807) was incurred as the proper supply chain management processes had not been followed. Payments amounting to R3 292 641 were not made in accordance with the approved delegations as per section 79 of the MFMA. These irregular payments were not included in the amounts disclosed in note 38 to the financial statements as required by section 125(2)(d)(i) of the MFMA.
18. I could not be provided with sufficient, appropriate audit evidence that management has properly identified, investigated and recorded all irregular expenditure transactions during the year under review. There were no satisfactorily alternative audit procedures that I could perform to confirm the completeness of irregular expenditure as disclosed in the financial statements.

### **Inventory**

19. Weaknesses and differences were identified during the physical verification of inventory in the previous year. Furthermore, inventory as disclosed in note 6 to the financial statements exceeded the balance of the inventory listings by R460 126 in the previous year. Consequently, sufficient appropriate audit evidence could not be obtained as to the existence, valuation and completeness of inventory amounting to R4 883 798 in the previous year and the municipality's records did not permit the application of alternative procedures. This matter was also reported in the previous year.

### **Revenue**

20. Sufficient appropriate audit evidence could not be presented for revenue relating to fines as disclosed in the statement of financial performance and the municipality's records did not permit the application of alternative procedures. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the accuracy and completeness of revenue relating to fines amounting to R765 069 as disclosed in the statement of financial performance.

### **Capital commitments**

21. Paragraph 83(c) of GRAP 17 states that the financial statements shall disclose for each class of property, plant and equipment recognised in the financial statements the amount of contractual commitments for the acquisition of property, plant and equipment. MIG project values were used to determine capital commitments amounting to R59 874 697 (2008: R50 375 681), as disclosed in notes 1 and 32 to the financial statements. The project values do not represent actual contractual commitments and therefore capital commitments are overstated. I was unable to quantify this overstatement as sufficient appropriate audit evidence could not be presented and the municipality's records did not permit the application of alternative procedures. Therefore, capital commitments are overstated by an unknown amount.

### **Cash flow statement**

22. Paragraph 13 of the Statement of GRAP, GRAP 2: *Cash flow statements* states that the separate disclosure of cash flows arising from investment activities is important because the cash flows represent the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. A cash outflow from investing activities, amounting to R28 798 075, due to acquisitions of property, plant and equipment as a result of the fixed asset reconstruction, is disclosed in the cash flow statement. This amount does not represent actual cash flow and sufficient supporting

documentation could not be presented to substantiate this disclosure. As disclosed in note 29 to the financial statements, numerous prior period errors were recognised and I could not determine to what extent these corrections affected the 30 June 2007 financial year. Therefore, I could not recalculate certain comparative cash flow line items as the movement between the 30 June 2007 and 30 June 2008 account balances could not be determined and the municipality's records did not permit the application of alternative procedures. The net cash flows from investing activities as disclosed in the comparative cash flow statement are therefore not accurate. The impact of this matter could not be determined. This matter was also reported in the previous year.

#### **Financial instruments**

23. International Financial Reporting Standard, IFRS 7 *Financial Instruments: Disclosures*, (IFRS 7) requires detailed disclosure of information about exposure to risks arising from financial instruments. Contrary to the prescribed disclosure requirement, the management of Moqhaka Local Municipality did not disclose the municipality's exposure to financial risk and how these risks are mitigated

#### **Disclaimer of opinion**

24. 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 matters on which I do not express a disclaimer of opinion:

#### **Going concern**

25. As disclosed in note 44 to the financial statements, there was a significant increase in the bank overdraft and the municipality may not be in the position to settle its current obligations in the normal course of business. The municipality incurred a substantial deficit in the current year, as disclosed in the statement of financial performance, and is experiencing serious difficulties with regard to debt collection. The municipality did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the national and provincial government for its continued sustainability. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. These are indicators that the municipality may be facing serious financial problems in terms of section 138 of the MFMA.

#### **Contingent liabilities**

26. With reference to note 34 to the financial statements, the municipality is the defendant in several lawsuits. The municipality is opposing the claims based on legal advice obtained. The ultimate outcome of these matters cannot presently be determined, and no provision for any liabilities that may result has been made in the financial statements. However, contingent liabilities amounting to R4 576 789 (2008: R1 498 411) have been disclosed in the financial statements.

#### **Fruitless and wasteful expenditure**

27. As disclosed in note 39 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R14 504 303 (2008: R10 351 889). The majority of these payments relate to a tourism event, which was considered to have been in vain, interest on loan

amounts as a result of exceeding payment terms, and items that were identified during a special investigation initiated by the council.

#### **Restatement of corresponding figures**

28. As disclosed in note 29 to the financial statements, the corresponding figures for 30 June 2008 have been materially restated as a result of errors discovered during the year ended 30 June 2008.

#### **Other matters**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

#### **Unaudited supplementary schedules**

29. The appendices set out on pages XX to XX do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

#### **Non-compliance with applicable legislation**

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

30. Although the municipality faces serious financial and cash flow problems. I could not determine whether the mayor had responded promptly to and initiated remedial or corrective steps proposed by the accounting officer to deal with such problems as required by section 54 of the MFMA.
31. Revenue was not reconciled on a weekly basis as required by section 64 of the MFMA.
32. Contrary to section 65(2)(e) of the MFMA, invoices amounting to R4 970 959 (2008: R335 061) were not paid within 30 days of receipt of the invoice.
33. The accounting officer did not notify the National Treasury of the overdrawn bank balance position as required by section 70(2) of the MFMA.
34. Compliance with the provisions of sections 116, 118 and 119 of the MFMA could not be confirmed as there was a general lack of controls over the safeguarding of important tender documents such as original, signed tender agreements.
35. Section 125(2)(e) of the MFMA states that the notes to the annual financial statements of a municipality must disclose particulars of non-compliance with this act. Although several instances of non-compliance with the MFMA were noted, none were disclosed in the notes to the financial statements.
36. The mayor did not table the 30 June 2008 annual report within seven months after the end of the financial year as required by section 127(2) of the MFMA. Furthermore, written explanations setting out the reasons for the delay were not submitted to the council in accordance with section 127(3) of the MFMA.

##### **Division of Revenue Act, 2008 (Act No. 2 of 2008) (DoRA)**

37. I could not confirm whether the municipality had certified to the National Treasury that it had exclusively appropriated each programme funded or partially funded by the allocation of Municipal Infrastructure Grant in its annual budget, as required by section 11(2)(a) of DoRA.
38. I could not confirm whether the municipality, within two months after the end of the financial year, had evaluated its performance in respect of programmes funded or partially funded by an allocation and had submitted such evaluations to the transferring national officer as required by sections 11(5) and 12(6) of DoRA.



## Governance framework

39. 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

40. 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 & 5	Property, plant and equipment	5				
6 & 7	Receivables		2	3		
8, 9 & 10	Payables		2	3		
11	Prior period errors		1	4		
12	Unauthorised expenditure	5				
13	Expenditure		2	3		
14	Employee-related costs		2	5		
15	Value-added tax		2	3		
16	Unspent conditional grants and receipts		2	3		
17	Irregular expenditure	5				
18	Inventory		2	3		
19	Revenue		2	2		
20	Capital commitments		1	4		
21	Cash flow statement		1	4		
22 & 23	Financial instruments		1	4		

### Overall reflections on the governance framework based on internal control deficiencies

41. Among finance staff there was a general lack of understanding of the new accounting framework. This, together with the nature and complexity of the valuation of assets and the unavailability of historical cost information, contributed towards qualifications in the financial statements of the municipality. The municipality experienced challenges in measuring the value of all assets under its ownership as these assets require a high level of specialised expertise and knowledge of asset management and systems to ensure fair presentation of the amounts reported in the financial statements. The accounting officer did not prioritise and take appropriate action to address lack of discipline in the finance and supply chain management directorate, resulting in non-compliance with applicable legislation and inadequate budget control measures. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure.
42. The chief financial officer did not sufficiently monitor the recording and reconciliation of the financial records. Sufficient control measures were not developed by the chief financial officer, in conjunction with his support team, to address the qualifications reported in the prior years as identified in the action plan.

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 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 in turn are 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 and responsibilities by personnel.	3
<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

43. 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	

No.	Matter	Y	N
<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		
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	X	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		X
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	X	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	X	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		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.	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 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 reflections on the governance framework based on other key governance requirements**

44. The financial statements were subjected to material amendments resulting from audit because the municipality engaged the consultants in preparing the financial statements and the underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework. Lack of understanding of the new accounting framework by the Chief Financial Officer resulting in the financial statements not being independently reviewed.
45. The municipality did not priorities the preparation of the annual report and the official who was tasked with the preparation of the annual report lack the expertise as it was also

experienced in the previous years that the annual reports were prepared with material inconsistencies and not in compliance with National Treasury guidelines. The Accounting officer engaged the consultants in preparing the annual report in the latter part of the audit process with the result that the annual report was not made available prior the tabling of the audit report.

46. The accounting officer did not prioritise the appointment of the audit committee upon expiry of the previous committee's term and therefore an audit committee was not in operation throughout the financial year. This also resulted in the committee not being able to fulfil all its responsibilities.
47. The internal audit function was not adequately staffed due to excessive vacancies. The internal audit unit was also engaged by the accounting officer in inappropriate functions such as initiating and recording transactions in the finance department during the current year, which resulted in the unit not being independent in order to fulfil all its responsibilities.
48. Prior year issues were not substantially addressed due to insufficient monitoring of recording and reconciliation of the financial records more especially the suspense accounts. The Chief Financial Officer in conjunction with other senior managers did not develop sufficient control measures to address the qualifications reported in the prior years.
49. The accounting officer did not prioritise the appointment of the risk officer and the internal audit was also engaged in the initiation of internal controls in the finance department as a result no risk assessment was performed during the current. Furthermore, in the absence of the risk officer no official was tasked with the monitoring of non compliance with applicable legislation and the challenges faced by the internal audit unit, no audit was performed to review compliance with regulations.
50. SCOPA resolutions were not substantially implemented because these resolutions were not prioritised and addressed by management. In preparing the action, monitoring and implementation of SCOPA resolutions were not allocated to specific officials with the result that no official took the responsibility to resolve them. Furthermore, due to internal audit engaged in inappropriate functions, no independent review was performed by the internal audit to ensure that SCOPA resolutions are in fact implemented.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Reporting on performance information**

51. I have reviewed the performance information as set out on pages xx to xx.

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

52. 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**

53. 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.
54. 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.

55. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the review findings reported below.

#### **Findings on performance information**

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

##### **Content of integrated development plan**

56. The integrated development plan of the Moqhaka Local Municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

##### **Existence and functioning of a performance audit committee**

57. The Moqhaka Local 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 regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

##### **Internal auditing of performance measurements**

58. Moqhaka Local Municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

##### **Lack of adoption or implementation of a performance management system**

59. Moqhaka Local Municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required by regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

##### **No mid-year budget and performance assessments**

60. The accounting officer of Moqhaka Local Municipality did not (by 25 January of each year) 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 of the MFMA.

##### **Content of the annual budget**

61. The annual budget for the financial year ended 30 June 2009 was not based on the development priorities and objectives referred to in section 26(c) of the MSA and measurable performance targets were not set by the municipality as required by regulation 6 of the Municipal Planning and Performance Management Regulations, 2001.

##### **Usefulness and reliability of reported performance information**

62. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its service delivery budget implementation plan and integrated development plan:
- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
  - Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?

- Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following review findings relate to the above criteria:

**Inconsistently reported performance information**

63. The Moqhaka Local Municipality has not reported on its performance with regard to all its objectives, indicators and targets as per the approved service delivery budget implementation plan and integrated development plan. The review findings mainly resulted from the fact that the municipality lacked documented performance management processes and internal controls, with the result that, for purposes of reporting the performance information, the municipality presumes that every head of department is aware of how and when performance information should be provided. In compiling the performance information, every department uses its own management processes regarding input, processing and reporting.

**APPRECIATION**

64. The assistance rendered by the staff of the Moqhaka Local Municipality during the audit is sincerely appreciated.

*Auditor-General*  
Bloemfontein

18 December 2009



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*