

# AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON THE MOQHAKA LOCAL MUNICIPALITY

## 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 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 financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA) and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 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 my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management as well as evaluating the overall presentation of the financial statements.
6. 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.

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## Basis for disclaimer of opinion

### Property, plant and equipment

7. Despite attempting alternative procedures, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, existence and valuation of and the rights to property, plant and equipment amounting to R1 144 079 112 (30 June 2010: R1 118 122 256) as disclosed in note 12 to the financial statements, due to the following:
- a) The fixed asset register of the municipality was reconstructed during the prior financial year. Engineering experts were appointed to determine fair values for the infrastructure assets as an acceptable substitute for historical cost in terms of GRAP Directive 7. This entailed the use of various technical engineering assumptions and judgments. I was unable to obtain sufficient appropriate audit evidence as to the consistent application of the expert's methodology due to a lack of appropriate documentation. This led to significant unresolved uncertainties around the reasonability and reliability of the valuations performed on infrastructure assets.
  - b) Immovable properties which were identified as municipal property on the valuation roll were not included in the fixed asset register. In the absence of an updated property valuation roll for the municipality, I was unable to determine the extent of the misstatement in the disclosed property, plant and equipment balance.
  - c) The asset register did not contain adequate descriptions, unique identification and locations to physically confirm the completeness and existence of property, plant and equipment. Unique identification was not allocated to all asset components in the asset register, assets with a book value of R65 942 883 were identified with no unique identification number and asset items to the amount of R3 596 020 with duplicated unique identification codes. Consequently, I was unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, valuation, completeness and the municipality's rights to property, plant and equipment to this amount.
  - d) Contrary to paragraph 61 of the SA Standard of GRAP 17, *Property, plant and equipment* proof could not be obtained that the residual values and the useful lives of assets were reviewed at reporting date and, if expectations differ from previous estimates, the changes were accounted for as a change in an accounting estimate in accordance with the SA Standard of GRAP 3, *Accounting policies, changes in accounting estimates and errors*.
  - e) Paragraph 19 of the SA Standard of GRAP 26, *Impairment of cash-generating assets* requires that property, plant and equipment should be assessed for impairment at each reporting date. Management did not assess whether there was a decrease in the value of property, plant and equipment during the financial year under review. Consequently, I could not obtain adequate audit assurance as to the valuation of the municipality's property, plant and equipment.
  - f) I was unable to obtain sufficient audit evidence of the valuation of immovable properties to the amount of R3 978 618, taking the estimated useful lives into account. Consequently, accumulated depreciation and property, plant and equipment is overstated with R3 978 618.

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### **Consumer receivables from exchange transactions**

8. In the absence of payments made after year-end as well as service contracts, indigent and arrangement applications, I could not verify the existence of consumer debtors of R54 915 833 (30 June 2010: R55 678 645) as disclosed in note 4 (gross balances) to the financial statements.
9. 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 these consumer debtors as indigent and there were also no satisfactory alternative audit procedures I could perform to confirm the status of these debtors as indigent.

### **Expenditure**

10. The occurrence, completeness and accuracy of depreciation amounting to R49 656 737 (30 June 2010: R45 000 356) as disclosed in the statement of financial performance could not be confirmed due to the limitations experienced regarding the valuation of property, plant and equipment (refer to paragraph 7 of this report). The municipality's records did not permit the application of alternative procedures.
11. The municipality did not provide sufficient appropriate audit evidence to confirm the accuracy and occurrence of expenditure transactions of R2 272 337 (30 June 2010: R3 244 094) as disclosed in the statement of financial performance. The system of control over the recording and classification of expense transactions was not adequate and as a result there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all these expense transactions had occurred and were correctly and accurately recorded and classified in the financial records of the municipality.

### **Revenue**

12. I could not obtain sufficient appropriate audit evidence regarding the occurrence and accuracy of rental income of R1 952 150 and admittance fees to the amount of R515 489 received during the year under review. The municipality's records did not permit the application of alternative procedures.
13. A number of consumers were identified that are charged a flat rate for water charges in the absence of an installed water meter. I have calculated the possible understatement in services charges income, based on average consumption of metered households, as R2 250 113 for the year under review.

### **Irregular expenditure**

14. During the audit, several instances were noted where the municipality did not comply with the requirements outlined in the Municipal Supply Chain Management Regulations and their own Supply Chain Management policy. Based on our assessment, irregular expenditure is understated with at least R13 858 034. However due to limitations placed on my audit of expenditure, I was unable to confirm the completeness of the disclosure made in note 48 to the financial statements.

### **Investment property**

15. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation of investment property amounting to R18 686 168 (2010: R23 213 775), as disclosed in the statement of financial position. I was unable to confirm the assumptions used by the expert

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regarding the cost, original purchase date of the property and the remaining useful lives of the property.

16. Paragraph 18 of the Statement of Generally Recognised Accounting Practise, GRAP 16: *Investment Property* (GRAP 16), states that investment property shall be recognised as an asset when it is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity and the cost or fair value of the investment property can be measured reliably. Investment property is understated due to municipal properties to the amount of R4 409 147, which are included in the valuation roll as municipal properties, not being included in the investment property register. Due to the lack of sufficient appropriate audit evidence it was impracticable to determine the total extend of this understatement and subsequently I was unable to confirm the completeness of investment property.
17. I was unable to confirm the rights and obligations of investment property to the amount of R3 470 908 in the absence of title deeds.

#### **Disclaimer of opinion**

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

#### **Emphasis of matters**

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

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

20. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of correcting prior year audit findings during the current financial year in the financial statements of Moqhaka Local Municipality at, and for the year ended, 30 June 2010.

#### **Going concern**

21. As disclosed in note 45, the ability of the municipality to continue as a going concern is dependent on a number of factors, including the need to obtain funding on a continuous basis.

#### **Unauthorised, irregular and fruitless and wasteful expenditure**

22. As disclosed in note 50 to the financial statements, the municipality incurred unauthorised expenditure of R32 132 650 (30 June 2010: R62 752 493) during the year under review due to inadequate budgetary control measures.
23. As disclosed in note 49 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R28 043 473 (30 June 2010: R21 444 126) during the year under review due to the municipality's inability to pay their creditors and obligations on time.
24. As disclosed in note 48 to the financial statements, the municipality incurred irregular expenditure of R88 698 826 (30 June 2010: R40 977 590) during the year under review due to inadequate procurement processes followed.

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### **Material losses/impairment**

25. As disclosed in note 47 to the financial statements, material losses to the amount of R43 537 967 (30 June 2010: R31 282 250) were incurred as a result of losses on water and electricity distribution.
26. A significant provision for impairment of receivables was created which constitutes 81% (R206 400 287/R254 067 694) of the total trade receivable balance (Note 4 to the financial statements).

### **Additional matters**

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**

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

### **Unaudited supplementary schedule**

28. The supplementary information set out on page 72 onwards does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

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

As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations: MFMA, DoRA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), Local Government: Municipal Planning and Performance Management Regulations of South Africa, 2001 (GNR.796 of 24 August 2001) and financial management (internal control).

### **Predetermined objectives**

Material findings on the report on predetermined objectives, as set out on pages xx to xx, are reported below:

### **Usefulness of information**

29. The reported performance information was deficient in respect of the following criteria:
  - Consistency: The reported objectives, indicators and targets are not consistent with the approved integrated development plan.
  - Measurability: The targets are not specific and time bound.

The following audit findings relate to the above criteria:

### **Reported objectives, indicators and targets are not consistent when compared with the planned objectives, indicators and targets (Consistency)**

30. The municipality has not reported throughout on its performance against the planned development objectives, indicators and targets as stated in the service delivery and budget implementation plan.

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**Planned and reported targets are not specific and time bound (Measurability)**

31. For the selected predetermined objectives, the planned targets were not specific of which the nature and the required level of performance could not be clearly identified and a number of the planned targets were not time-bound, of which the time period or deadline for delivery is not specified.

**Reliability of information**

32. The reported performance information was deficient in respect of the following criteria:

- Validity: Has the actual reported performance occurred and does it pertain to the entity, i.e. can the reported performance information be traced back to the source data or documentation?
- Accuracy: Has amounts, numbers and other data relating to reported actual performance been recorded and reported appropriately?
- Completeness: Have all actual results and events that should have been recorded been included in the reported performance information?

The following audit finding relates to the above criteria:

**The validity, accuracy and completeness of reported performance against targets could not be confirmed as inadequate supporting source information was provided (Reliability)**

33. The municipality has not reported throughout on its performance against the planned development objectives, indicators and targets as stated in the service delivery and budget implementation plan.

**Compliance with laws and regulations**

**Strategic planning and performance management**

34. The 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 sections 38, 39, 40 and 41 of the Municipal Systems Act and Municipal Planning and Performance Management Regulations 7 and 8.

**Budgets**

35. 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 Municipal Finance Management Act.

36. The monthly budget statements, mid-year budget and performance assessment report were not placed on the municipality's website, in contravention of the Municipal budget and reporting regulations.

37. The municipality's budget implementation plan was not approved within 28 days of the approval of the budget as required by section 53(c)(ii) of the Municipal Finance Management Act.

**Annual financial statements**

38. The 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 identified by the auditors were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.

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39. No annual performance report was submitted for audit purposes as required by section 46 of the Municipal Systems Act.

#### **Audit committees**

40. The audit committee did not effectively discharge its mandated as required by section 166(2) of the Municipal Finance Management Act.

41. 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**

42. The internal audit unit did not function as required by section 165(2) of the Municipal Finance Management Act, in that:

- Internal audit did not advise the accounting officer on matters relating to internal audit, internal controls, accounting procedures and practices and loss control.

43. The 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 by section 45(1)(a) of the Municipal Systems Act and Municipal Planning and Performance Management Regulation 14.

44. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager as required by Municipal Planning and Performance Management Regulation 14

#### **Human resource management and compensation**

45. 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 Municipal Systems Act.

#### **Expenditure management**

46. 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 Municipal Finance Management Act.

47. The accounting officer did not take reasonable steps to prevent unauthorised, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the Municipal Finance Management Act.

48. Section 125(2)(d)(i) of the MFMA requires the municipality to disclose in a note to the financial statements any material irregular expenditure and regulation 36(2) of the Supply Chain Management Regulations requires the municipality to disclose in a note to the financial statements the reasons for any deviations in terms of sub-regulation (1)(a) and (b). An amount of R36 987 584 is disclosed in note 48 as urgent matters which required deviations of SCM policy and tender regulations, this classification could not be confirmed.

49. The accounting officer did not inform the MEC for local government and the Auditor General of the unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality as required by section 32 of the Municipal Finance Management Act.

50. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the Municipal Finance Management Act.

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**Procurement and contract management**

51. The supply chain management policy is not in accordance with the Municipal Supply Chain Management Regulations in respect of section 12(1), 15 and 46(3)(c).

**INTERNAL CONTROL**

52. 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**

53. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance with laws and regulations and internal control.

**Financial and performance management**

54. Management and staff did not fulfil all their duties and responsibilities pertaining to financial and performance management. Systems were not appropriate to facilitate the preparation of the financial statements and performance reports.

**Governance**

55. The entity does not identify risks relating to the achievement of financial and performance reporting objectives. The audit committee did not effectively discharge its mandate during the year under review. Ongoing monitoring and supervision was not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting.

Bloemfontein

30 November 2011



AUDITOR - GENERAL  
SOUTH AFRICA

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