

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

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

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

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

4. I conducted my audit in accordance with the International Standards on Auditing read with General Notice 6/16 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. 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 auditors' judgment, 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 an evaluation of the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## Basis for adverse opinion

### Fixed assets

7. Fixed assets as disclosed in note 4 to the financial statements have been understated by the amount of R1 603 151. In addition to understatement, sufficient appropriate audit evidence could not be obtained as to the completeness, rights of ownership, existence and valuation of the amount disclosed to the value of R137 528 457 (2008: R137 381 409), due to the following:

a) The municipality entered into a service level agreement with an independent service provider to outsource the provision of electricity services. The service delivery agreement requires the electrical service provider to maintain bookkeeping and prepare the annual financial statements in respect of the electricity provision to annually provide the municipality with the surplus or deficit in the operational account. The electrical service provider's confirmation of surplus or deficit in the operational account includes a balance for fixed assets relating to assets of the municipality utilised by the service provider in fulfilling the terms of the agreement which was not considered during the preparation of the financial statements. This is as a result of a decision taken by management due to incorrect interpretation of the service level agreement and not considered the confirmation from the electrical service provider as the financial information of the municipality, consequently fixed assets as disclosed in note 4 to the financial statements is understated by R1 603 151.

b) Adequate supporting evidence to prove that sufficient control was exercised over the fixed assets of the municipality for the current year and prior year could not be provided. Management had not updated the fixed asset register since 1 July 2006, consequently a fixed asset register differs with the general ledger by an amount of R24 334 239 in the current year and R23 564 543 in the prior year. No evidence could be provided that a physical count of fixed assets was performed during the year or at year-end. The accuracy of the classification of assets as recorded in the financial statements could also not be confirmed due to the asset register not being classified according to the different services and the location of the assets was also not specified. Management did not update the fixed asset register with additions amounting to R5 885 268 which were purchased during the current financial year and R3 646 465 in the prior year. In the absence of updated fixed asset register, no alternative audit procedures could be performed. Accordingly, I was unable to determine whether any adjustments might have been necessary to the amount shown in the financial statements for fixed assets.

c) Management was unable to provide adequate supporting documentation relating to journals amounting to R797 307 in respect of fixed assets. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustment might have been necessary to the amounts shown in the financial statements for fixed assets.

### Expenditure

8. Expenditure as presented in the income statement have been understated by the amount of R9 822 608. Furthermore, I could also not obtain sufficient appropriate audit evidence for the actual expenditure presented in the income statement to the value of R21 556 392. Consequently, I could not confirm the occurrence, completeness, accuracy and classification due to the reasons detailed below.

- a) The electrical service provider's confirmation indicated an amount of R9 543 790 in respect of expenditure which was not considered in the preparation of the financial statements for the municipality, consequently expenditure is understated by R9 543 790.
- b) A journal was generated to adjust the provision for bad debts in the prior year in respect of electricity and arrear services. The journal was incorrectly allocated to the accumulated deficit instead of expenditure, consequently expenditure is understated and the accumulated deficit understated by the amount of R278 818.
- c) Management was unable to provide sufficient appropriate audit evidence in respect of payments as recorded in the general ledger amounting to R1 518 887 in the current year and R1 495 040 in the prior year. In the absence of adequate payment vouchers, alternative audit procedures could not be performed. Accordingly, I was not able to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for expenditure.
- d) Sufficient supporting documentation could not be provided by management for journal entries recorded against the expenditure accounts with a total value of R192 815 in the current year and R733 790 for the prior year. In the absence of journals attached with all the necessary supporting documents, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for expenditure.
9. Creditors disclosed in note 9 to the financial statements is understated by R6 265 678. While the creditors were not accurately disclosed, sufficient appropriate audit evidence could also not be obtained as to the existence, completeness, and obligations of the municipality to the amount disclosed in the financial statements amounting to R26 362 200 (2008: R21 054 168) due to the following:
- a) The financial information of the municipality as contained in the confirmation from the electrical service provider was not considered during the preparation of the municipality's financial statements, consequently creditors is understated by R1 836 031.
- b) The applicable basis of accounting requires that the financial records are prepared on the accrual basis. A journal to adjust the balance of a creditor's account was incorrectly generated and processed in the prior year. Consequently, creditors and accumulated deficit in the balance sheet were both overstated by R379 998.
- c) Payments received from debtors to the amount of R189 838 were allocated and disclosed as creditors in the annual financial statements of the prior year. The opening balances of creditors and debtors were therefore overstated with R189 838.
- d) Included in the creditors are debit balances to the amount of R5 499 483. This amount should have been disclosed as debtors, consequently debtors and creditors had been understated by the amount of R5 499 483.
- e) Management could not provide explanations or sufficient audit evidence for accounts to the total value of R5 135 150 in the current year and R851 880 in the prior year in respect of unreconciled VAT creditor included in Trade and Sundry Creditors as disclosed in note 9 to the financial statements. In the absence of

- sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to creditors as disclosed in the financial statements.
- f) Supporting documentation could not be provided by management in respect of journal entries having a debit amount of R1 18 594 and a credit amount of R4 158 210 recorded against the creditors accounts in the current year and R5 269 633 in the previous year in respect of unspent grants. In the absence of journals attached with appropriate supporting documentation, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to creditors as disclosed in the financial statements.
- g) Included in creditors as disclosed in note 9 to the financial statements were unknown and unreceipted deposits of R1 930 406 in the current year and R3 078 360 in the prior year. The outstanding balance of R1 930 406 is comprised of unknown deposits that have been outstanding for a period more than 24 months as well as cash control accounts for direct deposits which have been outstanding for a period more than 12 months. No evidence could be provided by management that a list of unknown deposits was reviewed, followed up on a regular basis and approved by an independent senior official. Accordingly, I was not able to determine whether any adjustments might have been necessary to creditors as disclosed in the financial statements.
- h) Included in creditors as recorded in the electrical service provider's confirmation in the prior year, was an amount of R102 257 relating to contributions made by the public for capital infrastructure expenditure. No calculations and supporting documentation could be provided for the contributions made by the public as revenue. Accordingly, I was not able to determine whether any adjustments might have been necessary to creditors and the surplus for the year as disclosed in the financial statements.
- i) Sufficient appropriate audit evidence relating to accruals raised at year end to the amount of R89 816 could not be provided by management. In the absence of adequate supporting documentation it was also not possible to perform alternative audit procedures.
- j) Management could not provide me with sufficient appropriate evidence for the difference amounting to R3 724 252 between the MIG grant for the bucket eradication program not utilized as disclosed in the prior year's financial statements and the contract registers. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to creditors as disclosed in the financial statements.
10. The confirmation from the electrical service provider included an amount of R753 951 in respect of the accumulated surplus which was not considered in the preparation of the financial statements for the municipality, consequently the accumulated deficit is understated by R753 951.

### Accumulated Deficit

11. The applicable basis of accounting requires that the financial records are prepared in such a way that expenses that apply to prior periods being segregated from the current results of the municipality. A journal to adjust the balance of the bonus provision and a reimbursement payment to an employee in the prior year was incorrectly generated and processed. Consequently, the deficit for prior year was overstated and the appropriations were understated in the income statement by R144 104.
12. Management could not provide sufficient appropriate audit evidence to confirm the completeness, existence and valuation of accumulated deficit to the amount of R24 861 597 (2008: R20 359 556) as disclosed in the balance sheet due to journals with a total value of R1 199 097 in the current year and R3 382 937 in the previous year recorded directly against the accumulated deficit in the form of appropriations which could not be provided. In the absence of journals with the necessary supporting documents, the entity's records did not permit the application of alternative audit. Accordingly, I was not able to determine whether any adjustments might have been necessary to the accumulated deficit for the year as disclosed in the financial statements.
13. Debtors as disclosed in note 7 to the financial statements are overstated by the amount of R930 197. In addition to the overstatement, sufficient appropriate audit evidence could not be obtained as to the existence, completeness, rights and obligations of debtors amounting to R9 879 354 for the current year and R9 380 073 for the previous year as disclosed due to the following:
- a) The electrical service provider's confirmation included the amount of R582 080 in respect of creditors which was not considered in the preparation of the financial statements of the municipality, consequently debtors is understated by R582 080.
- b) Included in debtors balance for the previous year is an amount of R1 512 277 relating to a debtor provided by the electrical service provider and was included in the confirmation submitted to the municipality. The debtor originates from revenue transactions in the records of the service provider as a result these transactions were incorrectly allocated to the debtor. Consequently, debtors are overstated and accumulated deficit understated by R1 517 277.
- c) An amount of R2 663 071 from the total of equitable share allocation received was used to settle the debtor accounts of indigent households in the prior year. No evidence could be obtained as proof that the monthly transactions and journals to account for these allocations were timely reviewed, revised or approved by a proper authorised official. In the absence of adequate supporting documentation, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts allocated to the indigent household's debtor accounts.
- d) Sufficient supporting documentation could not be provided by management in respect of debtor accounts to the amount of R2 059 257 in the previous year. In the absence of supporting documentation, the entity's records 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 of these debtors.

- e) Supporting documentation could not be provided by management in respect of journal entries recorded in Trade and Sundry debtors as disclosed in note 7 to the financial statements with a total value of R706 992 in the current year and R759 375 in the previous year. In the absence of journals with the necessary supporting documentation, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might have been necessary to debtors and the surplus for the year as disclosed in the financial statements.
- Income**
14. The electrical service provider's confirmation include an amount of R9 330 746 in respect of income that was not considered during the preparation of the financial statements of the municipality. Included in this income is prepaid electricity-free services amounting to R6 597 911, R164 193 in respect of prepaid electricity-free services recoverable and R59 687 relating to prepaid sales – free services recoverable that was reflected on the confirmation from the electrical service provider. No supporting documentation was submitted by management relating to these sales therefore I was unable to obtain sufficient appropriate audit evidence as to the occurrence, accuracy and classification of these sales.
15. Management was unable to provide a complete list/register of all rotating electricity meters registered in the municipal area as a result I was unable to obtain sufficient appropriate audit evidence on the completeness of revenue from the supply of conventional electricity amounting to R 2 568 641 in the current year and R1 914 975 in the prior year included in income as disclosed in the income statement. The amount of the current year was included in the R9 330 746 for income as indicated in the confirmation of the electrical service provider which was not considered during the preparation of the financial statements of the municipality.
16. The management of the municipality outsourced the management and collection of traffic fines to an external service provider. The contractual agreement signed between the municipality and the service provider states that a monthly fee equivalent to 30% of all fines collected in a calendar month will be recognised as revenue of the municipality. No control procedures were performed to monitor the compliance with the agreement or reconcile the amounts received from the service provider. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the accuracy and completeness of traffic fines income to the amount of R1 033 949 in the current year and R2 767 621 in the prior year included as actual income in the income statement.
17. Management was unable to provide explanations or supporting documentation for the difference between electronic and manual valuation roll amounting to R446 852 in respect of property and improvements, consequently, I was unable to confirm the accuracy of levies charged to consumers. Furthermore, the valuation roll had not been updated since 2004. The extent of the financial losses incurred could however not be quantified and the entity's records could not permit the performance of reasonable alternative audit procedures.
18. Management was unable to provide sufficient appropriate supporting documents relating to revenue transactions amounting to R3 911 920 included in actual income, as disclosed in the income statement. In the absence of supporting documentation, I was unable to obtain to perform alternative audit procedures to confirm the occurrence, accuracy and classification of these transactions.

19. A complete and efficient register in respect of properties and equipment available for rent in the prior year could not be provided by management. In the absence of registers, the entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations to confirm the occurrence, accuracy and completeness of rent income as disclosed in the income statement to the amount of R249 505.
20. The amount recorded in the municipal financial records in respect of pre-paid electricity income in the prior year amounted to R4 391 328 (excluding VAT). However the total amount for the year indicated in the prepaid electricity information system of the municipality in respect of pre-paid electricity sold was R4 751 933 (excluding VAT). Consequently, revenue and retained earnings were understated R360 605.
- Capital Commitments**
21. Register in respect of commitments for capital expenditure to the amount of R15 715 523 in the current year and R19 706 000 in the prior year as disclosed in note 22 to the financial statements could not be obtained. The amounts disclosed in the financial statement were merely the amounts according to the approved budget. In the absence of a commitment register with sufficient appropriate audit evidence that all commitments were properly identified and recorded, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of commitments as disclosed.
- Long-term liabilities**
22. The financial information included in the confirmation from the electrical service provider in respect of long term liabilities amounting to R1 603 150 was not considered in preparing the financial statements of the municipality. Due to the lack of sufficient appropriate audit evidence relating to individual loan agreements in respect of expenditure transactions for capital purchases by the electrical service provider on behalf of the municipality, I was unable to confirm by alternative means the carrying value of this long term liability amounting to R1 603 150 in the current year and R1 743 703 in the prior year. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence, completeness, valuation and allocation as well as obligations to the municipality in respect of long term liabilities in the confirmation provided by the electrical service provider.
23. Management was unable to provide adequate supporting documentation for fixed assets to the amount of R2 079 020 that served as collateral for the long term liabilities as disclosed in note 2.2 to the financial statements. In the absence of supporting documentation, I was unable to perform alternative audit procedures.
- Salaries, Wages and Allowances**
24. Due to the lack of supporting documentation, I could not obtain adequate audit evidence as to the occurrence, completeness, accuracy and classification of personnel expenditure to the amount of R 20 262 098 (2008: 19 640 348) included in actual expenditure as disclosed in the income statement due to the following:

- a) Management was unable to provide adequate supporting documentation relating to journals processed to record expenditure in respect of leave encashment and salary related costs with a total value of R105 551 and R276 051 respectively. In the absence of the necessary supporting documentation, the entity's records did not permit the application of alternative audit procedures.
- b) Sufficient appropriate audit evidence could not be provided by management in respect of employee related payments amounting to R1 978 486 in the current year and R3 301 617 in the prior year. In the absence of adequate supporting documentation it was not possible to perform alternative audit procedures.
- c) Management could not provide explanations for underpayments made to the amount of R171 191 on termination of services of deceased and previously employed employees. In the absence of sufficient explanations, I was unable to determine the accuracy of the amounts paid as exit benefits.
- Contingent liabilities and contractual obligations**
25. Leave pay outstanding and pro-rata bonus outstanding as at 30 June 2009 amounting to R2 173 695 and R511 453 respectively were incorrectly disclosed in note 21 to the financial statements. The amounts for the previous year were R2 307 384 and R426 173 respectively. These amounts do not meet the definition of a contingent liability and were also included as provisions in note 8 of the financial statements. Consequently, contingent liabilities are overstated by these amounts.
26. Contingent liabilities as disclosed in note 21 to the financial statements exclude the pending litigation identified during the audit against the previous municipal manager. Consequently, I could not be provided with sufficient appropriate audit evidence that management has properly identified all contingent liabilities during the year under review and there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of contingent liabilities as disclosed.
- Cash and Bank**
27. The confirmation of the electrical service provider in the prior year include a bank overdraft of R2 529 865. This balance was included in the balance of cash and cash equivalents as a bank overdraft as disclosed in note 10 to the financial statements of the municipality. The nature of this account in the books and records of the electrical service provider is a balancing account and not a bank account. Consequently, creditors are understated and the bank overdraft overstated by R2 529 865.
- Provisions**
28. The leave records of the municipality were not reliable for purposes of establishing the accuracy and completeness of leave to the credit of officials at year-end. Reliable records could not be generated from the system that distinguish between accumulated leave and capped leave, leave taken during the leave cycle to determine whether officials took minimum leave days as required by the collective agreement. It was established during the audit that leave was taken without obtaining approval from the immediate supervisor or the accounting officer, leave was captured on the system but approved leave forms could not be obtained and leave was approved but not captured onto the system. Due to the instances noted above, it could not be determined whether leave that should have been forfeited was also included in the calculation for leave provision. The leave records were therefore not a



reliable basis for calculation of the provision for leave as disclosed in note 8 to the financial statements. I was thus unable to obtain sufficient appropriate audit evidence as to the valuation of the provision for leave amounting to R2 173 695 in the current year and R2 307 384 in the prior year. In the absence of reliable leave records, I could not perform reasonable alternative audit procedures.

**Irregular expenditure**

29. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality in contravention of, or that is not in accordance with a requirement of this act, and which had not been condoned in terms of section 170; expenditure incurred by a municipality in contravention of or not in accordance with the requirement of the Municipal Systems Act and which had not been condoned in terms of the act; expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the municipality's supply chain management policy, and which had not been condoned in terms of such policy or by-law. As disclosed in note 26.1 to the financial statements, irregular expenditure in respect of the prior year to the amount of 94 437.

30. Irregular expenditure amounting to R45 980 707 in the current year and R478 736 in the prior year was identified during the audit and was not detected and prevented by the municipality's internal control. 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. This expenditure was not disclosed in the notes to the financial statements as required by section 125(2) of the MFMA. There were no satisfactory alternative audit procedures that I could perform to confirm the completeness of irregular expenditure. Irregular expenditure was incurred due to the following:

- a) Three verbal or written quotations were not obtained for the procurement of goods and services amounting to R86 525.
- b) No tender procedures were followed for the awarding of contracts to suppliers relating phase 2 and 3 of the Bucket eradication projects in Matlakeng amounting to R10 174 426.
- c) Expenditure amounting to R2 029 149 was incurred in respect of VAT services rendered outsourced to an independent consultant without following the tender procedures.
- d) Irregular expenditure to the amount of R409 510 in the prior year was incurred due to supply chain management policy and supply chain management regulations which were not adhered to.
- e) Adjustments were made to the salaries of the managers directly responsible to the municipal manager without obtaining the approval of the council or the speaker, which is contrary to the prescripts of section 60(1)(b) of the Municipal Systems Act. The payment for the prior year was R69 226. This constitutes irregular expenditure and is not disclosed in note 26.1 to the financial statements.
- f) Irregular expenditure was identified during the forensic investigation to the amount of R33 690 607 and was not disclosed in the note.

**Unauthorised expenditure**

31. Unauthorised expenditure is defined in section 1 of the MFMA as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 1(3), and includes overspending of the total amount appropriated for a vote in the approved budget, overspending of the total amount appropriated for a vote in the approved budget, and expenditure from a vote unrelated to the department or functional area covered by the vote. Overspending of the total amount appropriated for a vote in the approved operating budget was realised by the municipality to the amount of R7 131 362 in the current year and R8 701 575 in the prior year. This overspending was in respect of various votes within the budget and was not disclosed in the financial statements as required by section 125(2)(d) of the MFMA. Furthermore, the capital expenditure budget was exceeded by R784 832 in the current year and R186 942 in the prior year.
32. Unauthorised expenditure was identified during the forensic investigation to the amount of R838 600 due to expenditure not related to the services of the municipality and was not disclosed in the note.

**Fruitless and wasteful expenditure**

33. Fruitless and wasteful expenditure is defined in the MFMA as expenditure that was made in vain and would have been avoided had reasonable care been exercised. The municipality incurred fruitless and wasteful expenditure amounting to R625 702 in the current year and R1 133 795 in the prior year. This expenditure was not disclosed in the financial statements as required by section 125(2)(d) of the MFMA. Fruitless and wasteful expenditure was incurred due to the following:
- a) The technical evaluation report for Matlakeng Housing scheme indicates that the contract price to be paid to the contractor was R1 900 000 and the contractor was however paid R2 373 282 which is R473 282 more than what should have been paid. No explanations were provided for the overpayment. This amount constitutes fruitless and wasteful expenditure and is not included in note 26.2 to the financial statements
  - b) Additional interest and penalties was charged by the South African Revenue Services amounting to R133 401 in the current year and R356 165 in the prior year. These amounts constitute fruitless and wasteful expenditure and are not included in note 26.2 to the financial statements.
  - c) As disclosed in note 26.2 to the financial statements, accumulative fruitless and wasteful expenditure of R449 041 which was indicated as approved or condoned by council of which no council resolution could be obtained. Consequently, note 26.2 is understated by R449 041.
  - d) Fruitless and wasteful expenditure was identified during the forensic investigation to the amount of R19 019 and was not disclosed in the note.
  - e) The minutes of the bid evaluation committee in the prior year were changed to award a tender to another contractor as originally approved. The contract price of the contractor was R468 930 more than the price of the original successful contractor. This amount constitutes fruitless and wasteful expenditure and was not included in note 26.2
  - f) Additional interest was charged and capitalized against the capital amount by the financial institution due to non payment of installment by the municipality in the prior year. An amount of R228 000 in the prior year had already been paid against the

interest raised by the bank. This amount constitutes trustless and wasteful expenditure and was not included in note 26.2 to the financial statements.

(g) Reimbursement payments of R80 700 were made in the prior year to an employee who was not timely reinstated by the municipality. This amount does constitute trustless and wasteful expenditure and was not included in note 26.2 to the financial statements.

#### Adverse opinion

34. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, these financial statements of the Mhokare Local Municipality have not been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1.1.

#### Emphasis of matters

I draw attention to the following matters on which I do not express an adverse opinion:

#### Basis of accounting

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

#### Going Concern

36. As disclosed in the financial statements, paragraph 7 of the Chief Financial Officer's report, the municipality experienced serious difficulties regarding debt collection and there was no evidence that the municipality took action to deal with the defaulters. The debt collection period was significantly higher than the industry norm for other municipalities. Unspent conditional grants as disclosed in the financial statements amount to R13 397 290, and the municipality's short term investments amount to R2 379 573 which is an indication that project funds have been utilised to finance operating activities. It was further noted during the period under review that cash disbursements significantly exceeded cash collections. The liquidity ratios have decreased compared to the previous year and the municipality might not be in the position to meet its current obligations in the normal course of business. The municipality was significantly dependent on the national and provincial government for its continued sustainability. This along with other matters, are the indication of the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern.

#### OTHER MATTERS

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

#### Unaudited supplementary schedules

37. The supplementary information set out on pages XX to XX 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.

## Non-compliance with applicable legislation

### Municipal Finance Management Act

38. The municipality could not provide sufficient evidence and documentation to prove that they complied with the prescripts regarding municipal budgets as stipulated in sections 53, 54(1)(2), 69(1) & (3), 70(1) and 71 of the MFMA.
39. Contrary to section 64(h) of the MFMA, grant registers were not maintained and the grant reconciliations were not performed.
40. Reconciliations for revenue transactions were not performed as required in terms of section 64(2)(h) of the MFMA.

41. Contrary to the prescripts of section 65(2)(e) of the MFMA, numerous instances were identified where suppliers were not paid within 30 days to the amount of R50 485 and no proof could be obtained of any measures implemented to track the submission and payment of invoices to ensure compliance with this section of the MFMA. Furthermore, the municipality does not have a dedicated supply chain management unit.
42. No plan or program could be obtained with regard to unauthorised, fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA. Consequently, no evidence could be obtained with regard to compliance with management and reporting responsibilities of this expenditure as required by section 32 of the MFMA.
43. Monthly reconciliations of creditors' accounts were not performed as required by section 65(2)(j) of the MFMA.

44. Contrary to the MFMA circular 48 of 2009, the Municipal Infrastructure grants were not spent within the prescribed timeframes.

### Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

45. Declarations of interest could not be provided by the municipality for all the councillors. This is in contradiction to section 7(1) of schedule 1 of the MSA.
46. No evidence could be obtained that performance evaluation of employees were performed during the period under review, consequently I could not establish whether the requirement of section 67(1)(d) of the MSA were complied with.

### Division of Revenue Act, 2007 (Act No. 1 of 2007) (DORA)

47. I could not confirm that the municipality had certified to the National Treasury that it exclusively appropriated each programme funded or partially funded by the allocation of the Municipal Infrastructure Grant in its annual budget as required by section 11(2)(a) of the DORA.

### Governance Framework

48. 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 requirements addressed below:

**Internal control deficiencies**

49. 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 inefficiencies 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. In some instances deficiencies exist in more than one internal control component.

Para no	Basis for Adverse	CE	MA	CA	IC	M
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7.	Fixed Assets	5,7	1	1,3,6		
8.	Expenditure	5,7	1	1,3,6		
9.	Creditors	5,7	1	3,6		
10 – 12.	Accumulated deficit	5				
13.	Debtors	5,7	1	3,6		
14 – 20.	Income	5,7	1	1,3,6		
21.	Capital Commitments	5,7	1	2,3,6		
22 – 23.	Long-term Liabilities	5,7		6		
24.	Salaries, Wages and Allowances	5,7	1	1,3,6		
25 – 26.	Contingent liabilities and contractual obligations	5,7	1	2,3,6		
27.	Cash and Bank	5,7	1	1,3		
28.	Provisions	1,5	1	1,3,6		
29 – 30.	Irregular expenditure	5,7	1	1,3,5,6		
31 – 32.	Unauthorised expenditure	5,7	1	1,3,5,6		
33.	Fruitless and wasteful expenditure	5,7	1	1,3,5,6		

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

50. Inadequate leadership due to instability in the position of the chief financial officer has resulted in insufficient monitoring and supervision in finance section. Finance staff is not adequately trained to enhance technical competency with the intention that transactions will be appropriately recorded and classified. Even though the income accountant was appointed in an acting capacity in the position of the Chief Financial Officer, he resigned in this position in December 2008 leaving the finance section without leadership for approximately five months.

51. The positions of the municipal manager and the chief financial officer were filled in April and May 2009 respectively. Furthermore, critical vacancies existed within the finance section and lack of discipline in supply chain management directorate resulted in numerous non compliance with applicable legislation which the municipality's internal processes did not prevent or detect and the previous accounting officer did take action to remedy the circumstances. This, in turn resulted

in irregular, fruitless and wasteful as well as unauthorised expenditure. The municipality did not develop a plan to address the qualifications reported in the prior year.

Legend	
<b>CE = Control environment</b>	
1	The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.
2	Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.
3	Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.
4	Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.
5	The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.
6	Management's philosophy and operating style do not promote effective control over financial reporting. The entity does not have individuals competent in financial reporting and related matters.
<b>RA = Risk assessment</b>	
1	Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.
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>	
1	There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.
2	General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.
3	Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
4	Actions are not taken to address risks to the achievement of financial reporting objectives.
5	Control activities are not selected and developed to mitigate risks over financial reporting.
6	Policies and procedures related to financial reporting are not established and communicated.
7	Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.
<b>IC = Information and communication</b>	
1	Pertinent information is not identified and captured in a form and time frame to support financial reporting.
2	Information required to implement internal control is not available to personnel to enable internal control responsibilities.
3	Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	
1	Neither reviews by internal audit or the audit committee nor self-assessments are evident.
2	Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.
3	

52. 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
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	X	
Quality of financial statements and related management information			
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	
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.	X	
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.	X	
	• The audit committee operates in accordance with approved, written terms of reference.	X	
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	X	
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.	X	
	• The internal audit function operates in terms of an approved internal audit plan.	X	
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.	X	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.	X	
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	X	
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	X	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.	X	

53. The financial statements were subject to material corrections resulting from the audit. Although the municipality engaged the consultants in preparing the financial statements, the underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework.
54. The annual report was not submitted for consideration prior to the tabling of the auditor's report. Due to lack of capacity in the municipality to allocate the preparation of the annual report to the delegated official. Furthermore, the municipality does not have process in place to collate the information from the various departments for the preparation of the annual report.
55. Key officials were not available throughout the audit process as management did not prioritise the involvement in the audit process against service delivery initiatives and rather attends to other engagements to resolve legacy issues due to previous management.
56. The audit committee did not exist during the period under review due to challenges faced with the municipality to finance and to attract incumbents with relevant expertise to fill the positions of the committee.
57. The internal audit unit did not exist during the period under review due to challenges experienced by the municipality to attract incumbents with the necessary skills and expertise willing to take up the job in the area of Mohokare Local Municipality.
58. Internal controls were not designed in respect of financial and risk management due to management which did not prioritise the appointment of the risk officer. Furthermore, there were no internal controls with regard to non compliance with applicable laws and regulation and due to non existence of the internal audit unit; no monitoring was performed with regard to non compliance with laws and regulations.
59. Risk assessment was not performed during the period under review as the accounting officer did not prioritise the appointment of the risk officer.

**Overall reflections on the governance framework based on other key governance requirements**

No.	Matter	Y	N
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	X	
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.	X	
14.	SCOPA resolutions have been substantially implemented.	X	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.	X	
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.	X	
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the Mohokare Local 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	



60. Prior year audit findings were not addressed due to insufficient monitoring of recording and reconciliation of the financial records. Management did not develop an action plan to address the qualifications reported in the prior years.
61. SCOPA resolutions were not substantially implemented due to resolutions which were not prioritised and addressed by management. Furthermore, due to non existence of the internal audit unit, no independent reviews were performed to ensure that SCOPA resolutions are implemented.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

### Reporting on performance information

62. I was engaged to review the performance information
- The accounting officer's responsibility for the performance information**
63. 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

64. 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.

65. 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.
66. 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

#### No reporting of performance information

67. The annual report of the Mhokare Local Municipality could not be obtained, consequently I could not establish whether the annual performance report is included and whether it is prepared in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

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

68. The Mhokare Local Municipality did not adopt a framework that described 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 rules of the different role players, as required in terms of regulation 7 and 8 of the Municipal planning and Performance management Regulations, 2001.

## No mid-year budget and performance assessments

69. The accounting officer of the Mohokare Local Municipality did not (by 25 January of each) 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 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 integrated development plan

70. The key performance indicators set by the municipality did not include the general key performance indicators applicable to the municipality, as prescribed in terms of section 43(1) of the MSA.

## Content of the annual budget

71. 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.

## Existence and functioning of a performance audit committee

72. The Mohokare 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

73. The Mohokare 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.

## Usefulness and reliability of reported performance information

74. 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:

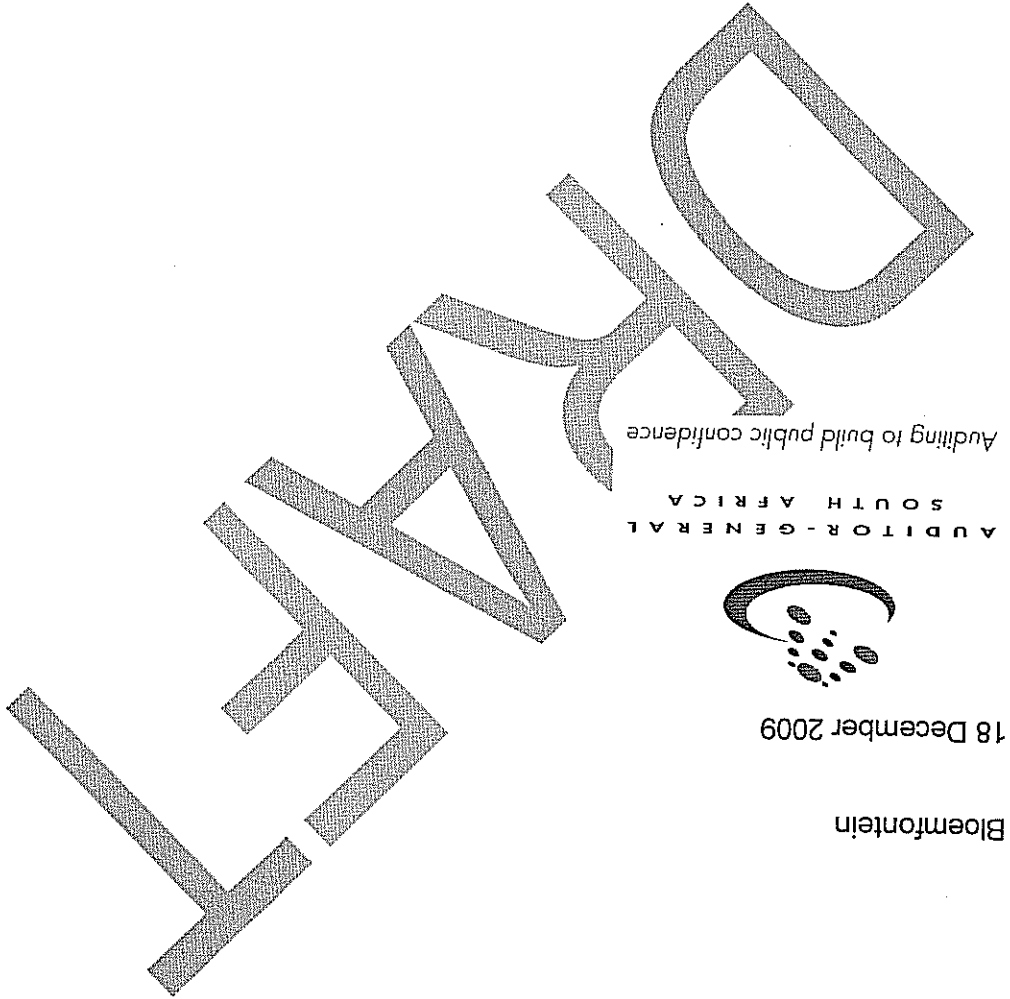
- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved annual performance plan/integrated development plan?
- Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined 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 audit findings relate to the above criteria:

75. An assessment could not be performed of the reliability of the reported performance information, as set out on pages XX to XX of the annual report, since the information was not received in time for audit purposes.

**APPRECIATION**

76. The assistance rendered by the staff of the Mohokare Local Municipality during the audit is sincerely appreciated.



18 December 2009

Bloemfontein