

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Mohokare Local Municipality, which comprise the statement of financial position as at 30 June 2010, 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). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 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 conducting the audit in accordance with the International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. 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

Basis for disclaimer of opinion

Consumer receivables

4. The South African Statement of General Accepted Accounting Practice (GAAP), IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* (IAS 39) states that after initial recognition, loans and receivables shall be measured at amortised cost using the effective interest method. Contrary to the above, consumer receivables as disclosed in note 2 to the financial statements were not measured at amortised cost. The estimated difference between the amount recorded in the financial statements and the amortised cost for the current financial year and the prior financial year could not be calculated due to the differences identified between the underlying accounting records and the financial statements.
5. IAS 39 states that an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. Contrary to the above, the municipality did not assess the consumer receivables, individually or by category, for any indication that these assets may be impaired. As disclosed in note 2 to the financial statements, the provision for doubtful debts amounted to R45 661 073 (2009: R45 636 278). The provision made was a general provision, with an amount consistent with

that of the prior financial year, and was not made in accordance with the above-mentioned standard. As no assessment of the receivables was performed, sufficient audit evidence to support the valuation of this provision, amounting to R45 661 073, could not be obtained and no alternative procedures could be performed.

6. Supporting documentation for certain indigent consumers could not be submitted to determine whether the applicants qualified for indigence. As a result, sufficient and appropriate audit evidence could not be obtained to verify the subsidies credited to receivables amounting to R616 755 (2008: R2 663 071). As the relevant information was not available, I was not able to confirm whether any adjustments were required to receivables in respect of indigents. Consequently, I did not obtain all the information and explanations I consider necessary to satisfy myself as to the valuation of consumer receivables.
7. I was not able to obtain sufficient appropriate audit evidence as to the existence of receivables amounting to R1 292 819, as I could not obtain evidence that subsequent payments were made by the consumers or that consumers had payment agreements. The matter occurred due to the failure by management to assess the existence of consumer receivables at year-end. Due to a lack of supporting documentation, no alternative procedures could be performed to obtain sufficient appropriate audit assurance as to the existence of receivables amounting to R1 292 819 included in consumer receivables disclosed in note 2 to the financial statements.
8. An unexplained difference of R361 950 was noted between the account balance of electricity receivables as per the underlying accounting records of receivables maintained by the electricity service provider and the general ledger. Due to the lack of information, I was unable to perform reasonable alternative audit procedures to provide me with the required audit assurance with regard to the receivable. Consequently, I was unable to obtain sufficient appropriate audit evidence in respect of the completeness and valuation of the electricity receivable of R475 706 as disclosed in the statement of financial position and note 2 to the financial statements.

Other receivables

9. The valuation of other receivables disclosed in note 3 to the financial statements amounting to R4 444 994 could not be confirmed. This was due to the fact that value-added tax (VAT) on payments for capital and operating expenditure amounting to R1 623 588 could not be traced to the input VAT account included in other receivables. It was also noted that the output VAT amounting to R259 694 and input VAT amounting to R4 713 987 in the general ledger did not reconcile with the total output and input VAT according to the VAT control account amounting to R7 086 881 and the VAT returns. The existence, right to and valuation of VAT receivables amounting to R2 372 894 could not be confirmed. The entity's records did not permit the application of alternative audit procedures.
10. The framework for the preparation and presentation of financial statements states that to be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Included in other receivables as disclosed in note 3 to the financial statements were receivables with credit balances amounting to R4 713 987. This should have been included as payables in note 8 to the financial statements. This resulted in the understatement of other receivables and payables by R4 713 987.

Cash and cash equivalents

11. Sufficient appropriate audit evidence could not be provided for debit journal entries amounting to R11 365 147 and credit journal entries amounting to R13 580 559 that were processed in the underlying accounting records of the municipality. Due to the lack of supporting documentation and explanations, no alternative procedures could be performed. Therefore, the valuation of cash and cash equivalents and the bank overdraft amounting to R802 396 and R1 494 654, respectively, as disclosed in note 34 to the financial statements could not be verified.
12. Included in cash and cash equivalent was an amount of R569 881 for petty cash. This amount was overstated by R568 701 due to the fact that expenditure amounting to R570 000 and income amounting to R1 299 were incorrectly allocated to the petty cash account. Expenditure was understated by R570 000 and revenue overstated by R1 299.

Inventory

13. Contrary to the SA Standards of GRAP, GRAP 101 *Agriculture*, an amount of R564 900 (2009: R492 999) for livestock was disclosed as inventory, whereas it should have been disclosed as biological assets in the statement of financial position. Any gain or losses arising from the biological assets, a description of each group of biological assets and a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period were also not disclosed in the notes. Inventory was thus overstated by R564 900 (2009: R 492 999) and biological assets understated by R564 900 (2009: R492 999).

Property, plant and equipment

14. Sufficient appropriate audit evidence could not be obtained as to the completeness, rights to, existence and valuation of property , plant and equipment disclosed in note 5 to the financial statements at a cost price of R143 514 291 (2009: R137 528 457), together with the accumulated depreciation amounting to R140 914 925 (2009: R136 738 736) due to the following:
 - No evidence could be provided that a physical count of assets had been performed during the year. The accuracy and classification of assets as recorded in the financial statements could also not be confirmed due to the fixed asset register not being classified according to the different services, the location of assets not being specified and the asset register not including values in all instances.
 - Management did not update the asset register with additions purchased amounting to R5 994 844 (2009: R5 885 268 and 2008: R3 646 465), resulting in an understatement of property, plant and equipment. In the absence of an updated fixed asset register, no alternative audit procedures could be performed.
 - Management was unable to provide adequate supporting documentation relating to journals processed in the prior year amounting to R797 307 in respect of property, plant and equipment. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustment might be necessary to the amounts shown in the financial statements for fixed assets.
 - A total of 47 of the 65 vehicles leased were delivered before 30 June 2010, but none of these vehicles had been capitalised as at 30 June 2010. The values of these assets could not be determined as the master operating lease agreement was silent on the values of these assets and the complete list of all assets. According to the amortisation table attached to the agreement, the capital amount to be paid back amounted to R25 701 376. The commitment and duration in terms of paragraph 4.1 of the master lease agreement indicated that the duration would be until the later of 96 months or the

date of expiry of the rental period as stated in the supply schedule, which could not be submitted for audit purposes. According to the lease agreement, ownership may transfer to the user in certain instances specifically defined in the rental schedules, but no such schedules could be submitted for audit purposes. Due to the lack of information, I could not confirm whether the agreement constituted a finance lease or an operation lease, nor the amounts to be included in the financial statements.

- The municipality has adopted the transitional provisions as outlined in directive 4 and the requirements of SA Standards of GRAP, GRAP 17 *Property, Plant and Equipment* as disclosed in note 5 to the financial statements. Contrary to the above, the accounting policy on property, plant and equipment as disclosed in note 1 to the financial statements stated that depreciation was calculated at historical cost, using the straight line method over the useful lives of the assets. The depreciation disclosed in note 5 amounting to R136 738 736 related to loans redeemed and other capital receipts that should have been written back to the surplus/deficit account. No supporting documentation could be provided to substantiate the accumulated depreciation amounting to R140 914 925 for the current financial year as disclosed in note 5 to the financial statements. The depreciation of R140 914 925 also contradicted the disclosure made in note 5 that assets would not be depreciated as the municipality has adopted the transitional provisions as outlined in directive 4 and GRAP 17. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustment might be necessary to the amounts shown in the financial statements for property, plant and equipment.
15. Payments for infrastructure and equipment amounting to R11 979 668 could not be traced to the capital assets in the general ledger. As a result, property, plant and equipment and revenue from government grants and subsidies as disclosed in the statement on financial performance were understated by R11 979 668.
 16. Journals amounting to R804 391 were incorrectly allocated to a payable account instead of to property, plant and equipment. This misallocation resulted in the understatement of property, plant and equipment and payables as disclosed in the statement of financial position by R804 391.
 17. Assets purchased to the amount of R205 819 were incorrectly expensed as repairs and maintenance (R77 250) and general expenses (R128 569). This misallocation resulted in the understatement of property, plant and equipment and the overstatement of the above expenditure.
 18. 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 included 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 for the prior year. As a result of the asset register still not agreeing with the financial statements, property, plant and equipment as disclosed in note 5 to the financial statements was overstated by R140 554 (2009: understated by R1 462 597). I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.

Consumer deposits

19. The obligation, existence and valuation of consumer deposits relating to the rotating electricity receivable accounts disclosed as R141 708 (2009: R72 934) in note 7 to the financial statements could not be confirmed. This was due to incorrect parameters set on the accounting system of the service provider, thus excluding consumer deposits applicable to the municipality from being included and disclosed as such. Furthermore, credit journals amounting to R73 990 and debit journals amounting to R5 006 were processed without sufficient supporting documentation. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine the extent of any adjustment that might have been necessary to the amounts shown in the financial statements.

Payables

20. The financial information of the municipality as contained in the confirmation from the electrical service provider was not considered during the preparation of the financial statements of the municipality for the prior year. Consequently, payables as disclosed in note 8 to the financial statements were understated by R1 336 031 for the prior year. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
21. Invoices in respect of the traffic services captured on the system were incorrectly captured as R3 364 313 instead of R2 090 170. A difference of R690 170 between the amounts paid and the invoices submitted could also not be explained. This was due to the lack of sufficient controls at the municipality to ensure that transactions were captured accurately on the financial system. The completeness and valuation of payables in respect of traffic fines could thus not be confirmed. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine the extent of any adjustment that might be necessary to the amounts shown in the financial statements.
22. IAS 39 states that financial liabilities should, after initial recognition, be measured at amortised cost using the effective interest method. In instances where the entity purchases goods on extended payment terms, the effect of the time value of money must be taken into account where material. Extended payment terms were granted to the municipality as most of the purchases were made on credit and no or limited interest was charged by suppliers as disclosed in the statement of financial performance. Contrary to the above, expenses with deferred payment terms were not discounted by the municipality. Furthermore, trade payables amounting to R6 096 389 as disclosed in note 8 to the financial statements were recorded at amortised cost. The municipality's records and information available did not permit the performance of alternative audit procedures regarding trade payables. Consequently, I could not calculate the amounts by which trade and other payables and interest were misstated. The valuation of trade payables could therefore not be confirmed.

Other payables

23. Management could not provide explanations or sufficient audit evidence for other payables to the total value of R5 135 150 (2009: R5 135 150) in respect of irreconcilable VAT payable included in other payables 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 confirm the obligations, valuation and existence of other payables amounting to R5 135 150.
24. Management could not provide explanations or sufficient audit evidence for other payables to the total value of R2 530 372 (2009: R3 039 616) 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 confirm the obligations, valuation and existence of other payables amounting to R2 530 372 (2009: R3 039 616).

25. Management could not provide explanations or sufficient audit evidence in the prior year for accounts to the total value R1 053 142 in respect of unknown deposits included in other payables 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 confirm the obligations, valuation and existence of other payables amounting to R1 053 142.

Unspent conditional grants

26. The obligation, existence and valuation of unspent conditional grants disclosed as R8 583 409 (2009: R13 397 280) in the statement of financial position and note 10 to the financial statements could not be verified. No proper register or other sufficient appropriate documentation could be obtained to confirm the opening balances, the portion of the grant spent or transferred to revenue, and the closing balances. Alternative audit procedures could not be performed due to the extent of the weakness identified and the fact that the municipality's records did not permit the application of alternative procedures.
27. Unspent conditional grants as disclosed in the statement of financial position were overstated and other receivables as disclosed in the statement of financial position understated by R2 105 484, as unspent grant accounts with debit balances were incorrectly included in note 10 to the financial statements.

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. This was due to accrued leave not always being accurately calculated, leave taken that could not always be substantiated by approved leave forms or other supporting documentation, and leave taken that was not always recorded in leave records. The leave records were therefore not a reliable basis for calculation of the provision for leave as disclosed in note 12 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 R1 495 528 (2009: R2 173 695). In the absence of reliable leave records, I could not perform reasonable alternative audit procedures.

Long-term liability

29. No loan agreements could be obtained from the service provider for the loan included under long-term liabilities in the statement of financial position and in note 13 to the financial statements amounting to R1 888 655 (2009: R1 603 150). Alternative procedures performed to obtain loan agreements were unsuccessful and the municipality's records did not permit the application of further alternative audit procedures regarding these loans. I was therefore unable to confirm the obligations, existence and valuation of these loans. The disclosure and calculation of the current portion of long-term liabilities could also not be confirmed due to the limitations identified above.

Accumulated deficit

30. An unexplained difference of R7 653 715 existed on 30 June 2010 between the balance of the accumulated deficit in the underlying accounting records and the accumulated deficit as disclosed in the statement of financial position and the statement of changes in net assets.

Furthermore, management could not provide me with sufficient appropriate audit evidence regarding journals with a net value of R11 219 618 (2009: R1 947 653) processed against the accumulated deficit account. In the absence of the supporting documentation and explanations regarding the journals and the lack of reconciliations between the general ledger account and the amount disclosed in the financial statements, no alternative audit procedures could be performed. The limitation of scope consequently resulted in me not being able to confirm the valuation of the accumulated deficit as disclosed in the statement of financial position.

31. The corresponding amounts for expenditure, payables and accumulated surplus were not restated in terms of the SA Standard of GRAP, GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, in respect of expenditure amounting to R1 078 695 relating to the prior year, but were recorded in the accumulated deficit account. This resulted in the accumulated deficit for the 2008-09 financial year being understated by R1 078 695.
32. Supporting documentation could not be obtained for audit purposes for the transactions processed as prior year errors as disclosed in the statement of changes in net assets amounting to R11 072 909 and note 24 to the financial statements amounting to R6 718 209. The lack of supporting documentation resulted in a limitation of scope on my audit and therefore the occurrence and accuracy of the prior year errors as disclosed could not be verified. Due to the lack of supporting documentation, no alternative audit procedures could be performed.

Revenue

33. As management was unable to provide a complete list or register of all rotating electricity meters registered in the municipal area, I was unable to obtain sufficient appropriate audit evidence on the completeness of service charges from the supply of conventional electricity amounting to R3 024 576 (2009: R2 568 641), included in service charges in the statement of financial performance and note 15 to the financial statements. The municipality's records did not permit the application of alternative audit procedures regarding rotating electricity meters.
34. 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 fine income to the amount of R576 152 (2009: R1 033 949), included in other income in the statement of financial performance and note 17 to the financial statements. The municipality's records did not permit the application of alternative audit procedures regarding income from traffic fines.
35. Management was unable to provide explanations or supporting documentation for the difference between the electronic and manual valuation roll amounting to R4 253 711 (2009: R446 852). I was unable to confirm the accuracy and completeness of property rate income disclosed as R6 068 129 (2009: R4 180 942) in the statement of financial performance and note 14 to the financial statements. The entity's records did not permit the performance of reasonable alternative audit procedures.

36. Management was unable to provide the prepaid electricity sales data for the period 1 April 2010 to 30 June 2010. I was unable to confirm the accuracy and completeness of prepaid sales amounting to R8 543 430 included in sale of electricity disclosed in the statement of financial performance and note 15 to the financial statements. The entity's records did not permit the performance of reasonable alternative audit procedures.
37. Management was unable to provide sufficient appropriate supporting documents relating to revenue transactions and journals amounting to R1 724 920 (2009: R 2 647 665) and R2 188 329 (2009: R4 705 921), respectively. In the absence of supporting documentation, I was unable to perform alternative audit procedures to confirm the occurrence, accuracy and classification of these transactions.
38. The electrical service provider's confirmation included an amount of R9 330 746 in respect of revenue for the prior year that was not considered during the preparation of the financial statements of the municipality. Consequently, revenue for the prior year as disclosed in the statement of financial performance was understated by R9 330 746. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
39. Not all water meter readings used to levy service charges during the year were correct. In certain instances it was also identified that the water consumption was not billed or that water service charges were incorrectly calculated. As the municipality did not have reliable processes to ensure that water consumption was accurately billed, I was not able to obtain sufficient appropriate audit evidence in respect of the accuracy, occurrence and completeness of water levies amounting to R1 925 421 included in service charges in the statement of financial performance and note 15 to the financial statements.
40. A complete and efficient register in respect of properties and equipment for rent could not be provided by management. In the absence of registers, the municipality's records did not permit the application of alternative audit procedures. Consequently, I did obtain all the information and explanations I considered necessary to confirm the occurrence, accuracy and completeness of rent income as disclosed in the statement of financial performance to the amount of R397 613 (2009: R421 957).
41. Management was unable to provide explanations or supporting documentation for the difference between government grant income amounting to R29 465 781 according to the statement of financial performance and the external confirmation obtained amounting to R32 768 618. Accordingly, I was not able to confirm the occurrence, accuracy and completeness of government grant income as disclosed in the statement of financial performance. The entity's records did not permit the performance of reasonable alternative audit procedures.

Expenditure

42. Management was unable to provide sufficient appropriate audit evidence in respect of payments as recorded in the general ledger amounting to R1 262 228 (2009: R1 518 887). Furthermore, expenditure vouchers for transactions with a projected value of R1 188 648 could not be obtained. In the absence of adequate payment vouchers, alternative audit procedures could not be performed. Accordingly, I was not able to confirm the occurrence, accuracy and classification of this expenditure.
43. Sufficient supporting documentation for journals could not be provided by management for entries recorded against the expenditure accounts with an estimated projected value of R1 174 174 (credit) (2009: R133 665 debit). In the absence of the necessary supporting documents attached to journals, the entity's records did not permit the application of

alternative audit procedures. Accordingly, I was not able to confirm the occurrence, accuracy and classification of these transactions.

44. The electrical service provider's confirmation indicated an amount of R9 543 790 in respect of expenditure for the prior financial year, which was not considered in the preparation of the financial statements of the municipality. Consequently, expenditure for the prior year was understated by R9 543 790. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
45. Material re-classifications were made to the expenditure for the prior year compared to the financial statements for the year ended 30 June 2009, as the accounting framework changed to SA Standards of GRAP. However, working papers and supporting documentation for the re-allocations could not be submitted. Furthermore, the expenditure for the prior year differed with R722 997 from the underlying accounting records obtained for audit purposes. In the absence of working papers, supporting documentation and reconciliations between the underlying accounting records and the financial statements, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to confirm the occurrence, completeness, accuracy and classification of expenditure for the prior year as disclosed in the statement of financial performance.
46. Invoices attached to payment vouchers were not signed by the receiver of the goods as evidence that the goods were in fact received by the municipality. Due to the lack of proof that the goods had been received by the municipality, the occurrence of this expenditure amounting to a projected value of R1 550 437 could not be confirmed. The municipality's records did not permit the application of alternative audit procedures regarding the occurrence of this expenditure.
47. Payments amounting to R1 563 640 could not be traced to the expenditure vote in the general ledger. This expenditure was incorrectly allocated to the credit control account and not allocated to operating expenditure. As a result, operating expenditure was understated by R1 563 640. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
48. Bulk purchases of electricity were understated by R508 541 due to an incorrect journal passed in this regard by the electrical service provider. The matter occurred due to the fact that the management of the municipality had no reviewing access over the journal entries processed by the electrical service provider. I could not determine the effect on the other account balances or classes of transactions contained in the financial statements.
49. According to supporting documentation, payments were made to two separate suppliers for the same photocopy machines with the same serial numbers. An amount of R1 079 358 was paid to the one supplier and R297 744 to the other. As no further supporting documentation could be obtained, the expenditure disclosed in the statement of financial performance could be overstated.

Employee-related cost

50. Reconciliations were not performed between the amount for employment-related cost (including remuneration of councillors) according to the payroll system and the amounts captured on the underlying accounting records and disclosed in the financial statements. An unexplained difference of R4 821 771 existed between the total employee-related cost according to the payroll system (R20 468 056) and the amount captured in the general ledger and disclosed as employee-related cost and remuneration of councillors (R25 289 827) in the statement of financial performance and notes 18 and 19 to the financial statements. The municipality's records did not permit the application of alternative audit

procedures regarding the unexplained difference between the amounts disclosed in the financial statements compared to the payroll system. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy, occurrence and classification of the employee-related cost and remuneration of councillors.

51. The accounting framework changed to SA Standards of GRAP during the year under review and no supporting documentation could be provided to confirm the change in the balance for salaries, wages and allowances from R21 204 327 as disclosed in the prior financial statements to R20 262 098 according to SA Standards of GRAP as disclosed in the statement of financial performance and note 18 to the financial statements of the current year. The municipality'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 satisfy myself as to the accuracy, occurrence and classification of these expenses.
52. Adequate supporting documentation relating to journals processed to record employment-related costs amounting to R241 729 (2009: R381 602) could not be obtained for audit purposes. The municipality's records did not permit the application of alternative audit procedures regarding salary-related costs. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy, occurrence and classification of employee-related costs as disclosed in the statement of financial performance.
53. Adequate supporting documentation, such as employment contracts, annexures to the contracts stipulating the salary and allowances of employees, personnel files and supporting documents for allowances paid, could not be obtained for employee-related cost amounting to R573 342 (2009: R1 978 485). The municipality'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 satisfy myself as to the accuracy, occurrence and classification of these expenses.

Capital commitments

54. A register could not be obtained for audit purposes of capital commitments approved and contracted of R26 649 008 (2009: R15 715 523) and approved and not yet contracted of R12 460 000, as disclosed in note 22 to the financial statements. In the absence of a commitment register with sufficient appropriate audit evidence indicating that all commitments had been properly identified and recorded, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of commitments as disclosed.

Contingent liabilities

55. According to the SA Standard of GRAP, GRAP 19 *Contingent Liabilities*, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable, an estimate of its financial effect, an indication of the uncertainties relating to the amount or timing of any outflow, as well as the possibility of any reimbursement. The municipality only disclosed a short narrative of the labour cases pending without reference to the financial effect, the uncertainties relating to the amount and the timing of any possible outflows in note 26 to the financial statements. Furthermore, the completeness of the contingent liabilities disclosed in note 26 to the financial statements could not be verified, as five additional possible contingent liabilities amounting to R507 356 were identified during the audit process.

Operating leases

56. A lease register supported by lease contracts could not be obtained for audit purposes. Through inspection of payments and the accounting records, possible leases with total lease payments during the year amounting to R2 202 226 were identified that were not disclosed in note 35 to the financial statements. Due to this and the lack of a lease register supported by lease contracts, the accuracy, classification and completeness of the operating leases disclosed in note 35 to the financial statements could not be verified. No alternative audit procedures could be performed to obtain sufficient appropriate audit evidence.
57. According to the SA Standard of GRAP, GRAP 13 *Leases*, a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. Contrary to this requirement, the minimum future lease payments disclosed in note 35 to the financial statements amounting to R668 160 (2009: R835 200) were for a finance lease and not an operating lease. These amounts were therefore overstated in note 35 regarding operating leases in the financial statements.

Irregular expenditure

58. The expenditure listed below complies with the definition of irregular expenditure as set out in section 1 of the MFMA but was not disclosed in note 38.2 to the financial statements as required in terms of section 125(2)(d) of the MFMA:

Irregular expenditure for the 2009-10 financial year:

- Irregular expenditure to the amount of R25 788 491 (2009: R86 525) was incurred as the supply chain management policy and supply chain management regulations not having been adhered to.
- Expenditure amounting to R1 480 066 was incurred without the authorisation of the municipal manager, the chief financial officer or a properly delegated official as required by section 106 of the MFMA.

Irregular expenditure for the 2009-10 financial year:

- Expenditure of R2 029 149 was incurred during the prior year in respect of VAT services outsourced to an independent consultant without following the tender procedures.
- Adjustments were made to the salaries of the managers directly responsible to the municipal manager during the 2008-09 financial year without obtaining the approval of the council or the speaker, which was contrary to the prescripts of section 60(1)(b) of the Local Government: Municipal Systems Act, 2000 of South Africa (Act No. 32 of 2000) (MSA). The payments amounted to R69 226.
- Irregular expenditure was identified during a forensic audit conducted in the prior year amounting to R33 690 607.

59. Furthermore, I could not be provided with sufficient appropriate audit evidence that management had properly identified, investigated and recorded all irregular expenditure transactions during the current and prior year. Due to the limitations placed on the scope of the work performed relating to expenditure and the procurement of property, plant and equipment procurement, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of irregular expenditure, as disclosed in note 38 to the financial statements.

Fruitless and wasteful expenditure

60. Fruitless and wasteful expenditure is defined in section 1 of the MFMA as expenditure that was made in vain and would have been avoided had reasonable care been exercised. The following fruitless and wasteful expenditures were identified and were not disclosed in note 38.1 to the financial statements as required in terms of section 125(2)(d) of the MFMA:

Fruitless and wasteful expenditure for the 2009-10 financial year:

- A contract for traffic services terminated early which resulted in a settlement payment of R438 596 to the service provider.
- Additional interest and penalties amounting to R188 815 (2009: R133 401) were charged by service providers and the South African Revenue Service.

Fruitless and wasteful expenditure for the 2009-10 financial year:

- The technical evaluation report for the Matlakeng housing scheme indicated that the contract price to be paid to the contractor was R1 900 000. However, the contractor was paid R2 373 282 during the prior year, which was R473 282 more than what should have been paid. No explanations were provided for the overpayment.
- Fruitless and wasteful expenditure was identified during a forensic investigation in the prior year amounting to R19 019.

61. According to note 38.1 to the financial statements, fruitless and wasteful expenditure amounting to R207 430 for the 2009-10 financial year and R449 041 for prior year were condoned by the council. According to underlying records these fruitless and wasteful expenditures were only approved to be condoned during October 2010. Consequently fruitless and wasteful expenditures disclosed in note 38.1 to the financial statements were understated by these amounts.

62. Processes, controls and a register were not in place to ensure that all fruitless and wasteful expenditure was identified and disclosed in the financial statements. Due to the lack of controls and a register to ensure the complete disclosure of fruitless and wasteful expenditure, alternative procedures could not be performed to obtain sufficient appropriate audit evidence as to the completeness of fruitless and wasteful expenditure of R207 430 disclosed in note 38.2 to the financial statements.

Presentation and disclosure

63. Contrary to GAAP, IFRS 7 (AC 144) *Financial Instruments: Disclosures*, the financial statements did not disclose the risks arising from financial instruments that the entity was exposed to and how they had been managed.

64. The distribution loss from the electricity service was not disclosed in the notes to the financial statements as required in terms of section 125(2)(d) of the MFMA. The distribution loss for electricity could not be determined as a result of a lack of information to confirm the loss. Due to the lack of controls, information and reconciliations to calculate the distribution loss, alternative procedures could not be performed to determine the loss.

Statement of changes in net assets

65. Several material unexplained differences were identified regarding the amounts disclosed in the statement of changes in net assets. According to the prior financial statements, funds and reserves amounted to R5 118 483 and R5 672 077 as at 30 June 2008 and 30 June 2009, respectively. The statement of changes in net assets indicated that the balance of funds and reserves amounted to R5 737 266 and R0 as at 30 June 2008 and 30 June 2009, respectively. As the relevant supporting information was also not available, I was not able to confirm the adjustments that were required to correct the statement of changes in net assets.

Cash flow statement

66. Due to the extent of the audit differences, together with the extensive limitation of scope placed on the audit as highlighted in the Basis for disclaimer of opinion paragraphs above, the accuracy of the cash flow statement and the notes thereto could not be verified. No

alternative audit procedures could be performed on the cash flow statement as the municipality's records did not permit this. Consequently, I did not obtain all the information and explanations I consider necessary to satisfy myself as to the accuracy of the figures disclosed in the cash flow statement.

Disclaimer of opinion

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

Emphasis of matters

I draw attention to the following matters on which I do not express a disclaimer of opinion:

Restatement of corresponding figures

67. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of the conversion to SA Standards of GRAP and errors discovered during the 2009-10 financial year in the financial statements of the Mohokare Local Municipality at, and for the year ended, 30 June 2009.

Financial sustainability

68. As disclosed in note 42 to the financial statements, the municipality is experiencing financial difficulty. The municipality experienced serious difficulties regarding debt collection and there was no evidence that the municipality had taken action to deal with the defaulters. The debt-collection period was significantly higher than the industry norm of other municipalities and was disclosed as 692 days. Unspent conditional grants as disclosed in the financial statements amounted to R8 583 409 and the municipality's short-term investments amounted to R288 601, which indicated that project funds were utilised to finance operating activities. It was further noted during the period under review that cash disbursements significantly exceeded cash collections. The municipality is significantly dependent on grants from national and provincial government for its continued sustainability. This indicates the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern rendering services to the community.

Additional matters

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

Material inconsistencies in information included in the annexures to the financial statements

69. The annexures to the financial statements, set out on pages xx to xx, contained material errors and the information contained therein was inconsistent with the information contained in the annual financial statements in respect of loans.

Unaudited supplementary information

70. 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 annexures and accordingly I do not express an opinion thereon.

Supplementary explanations of budget variances presented outside the financial statements

71. The supplementary explanations of budget variances contained in the supplementary schedules as referred to in note 36 to the financial statements do not form part of the financial statements. I have not audited these explanations 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 MFMA, DoRA, MSA and Municipal Supply Chain Management Regulations of South Africa (GNR.868 of 30 May 2005) (SCM regulations), and financial management (internal control).

Predetermined objectives

Non-compliance with regulatory and reporting requirements

Existence and functioning of a performance audit committee

72. The performance audit committee did not:

- review the quarterly reports of the internal auditors on their audits of performance measurements of the municipality
- review the municipality's performance management system and make recommendations in this regard to the council.

Internal auditing of performance measurements

73. 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 in terms of section 45 of the MSA.

Lack of adoption or implementation of a performance management system

74. The municipality did not adopt a framework that described and represented how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required in terms of sections 36, 38 and 41(2) of the MSA and regulations 7 and 8 of the South African Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

75. The accounting officer of the 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.

Inadequate content of integrated development plan

76. The integrated development plan (IDP) of the 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 South African Municipal Planning and Performance Management Regulations, 2001.

77. Evidence could not be obtained that the IDP of the municipality included the vision for the long-term development of the municipality relating to the municipality's internal transformation needs, identified communities that did not have access to basic municipal services, and included the institutional framework required to implement the integrated development plan, as required by section 26(a) to (c) of the MSA.

Incomplete reporting on all predetermined objectives, indicators and targets

78. No indicators and targets were specified in the IDP for the year under review. Furthermore, in 21 instances it was indicated in the performance report that the data for the actual achievement was unavailable.

Usefulness of reported performance information

79. The following criteria were used to assess the usefulness of the planned and reported performance:

- **Consistency:** Has the department reported on its performance with regard to its objectives, indicators and targets in its approved strategic and annual performance plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- **Relevance:** Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- **Measurability:** Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable and time bound?

The following audit findings relate to the above criteria:

Planned and reported indicators or measures not verifiable

80. For 12 selected objectives, 12 (100%) of the planned and reported indicators were not verifiable, as it was not possible to validate the processes and systems that produced the indicator.

Compliance with laws and regulations

Municipal Finance Management Act

Accounting officer did not adhere to his statutory responsibilities

81. Contrary to section 62(1)(c)(i) the MFMA, I could not obtain any evidence that the municipality had designed and implemented a fraud prevention plan and risk management policy for the year under review; neither could any proof be obtained that the municipality had developed any independent channels through which suspected fraud and corruption could be communicated.

The financial statements were not prepared in accordance with applicable legislation

82. The municipality did not prepare financial statements that fairly presented the state of affairs of the municipality; its performance against its budget; its management of revenue, expenditure, assets and liabilities; its business activities; its financial results, and its financial position at the end of the year, as required in terms of section 122(1) of the MFMA.

83. Contrary to section 65(2)(c) of the MFMA, the municipality did not maintain effective, efficient and transparent systems of internal control for payables, as monthly reconciliations of payables were not performed.

Disciplinary and criminal proceedings in instances of financial misconduct were not conducted

84. Contrary to section 62(1)(e) of the MFMA, the municipality did not investigate financial misconduct against certain officials responsible for irregular as well as fruitless and wasteful expenditure.

The audit committee was not functioning properly

85. It could not be confirmed whether the audit committee had advised the council on matters relating to internal financial control and internal audits as required by section 166(2)(a) of the MFMA.

86. Contrary to the requirements of section 166(2)(c) of the MFMA, the audit committee did not respond to the council on the audit findings raised in the prior financial year.

The internal audit unit was not functioning properly

87. Contrary to section 165(1) and (2) of the MFMA, the municipality did not have a functioning internal audit unit for the year under review.

Expenditure was not paid within the set parameters in accordance with legislation

88. Contrary to section 65(2)(e) of the MFMA, numerous instances amounting to R5 172 539 were identified where suppliers were not paid within 30 days from receipt of an invoice.

Expenditure was incurred in contravention of, or not in accordance with, applicable legislation, resulting in irregular expenditure

89. Expenditure was incurred that was not in accordance with the requirements of the municipality's supply chain management policy, resulting in irregular expenditure as defined in section 1 of the MFMA.

Expenditure incurred was made in vain or could have been avoided, resulting in fruitless and wasteful expenditure

90. Expenditure was incurred that could have been avoided had reasonable care been exercised, resulting in fruitless and wasteful expenditure as defined in section 1 of the MFMA.

Municipal Systems Act

Supply chain management legislative requirements were not implemented or adhered to

91. Annual declarations of interest were not made by the councillors and staff members as required in terms of schedules 1 and 2 of the MSA.

Municipal regulations

Supply chain management legislative requirements were not implemented or adhered to

92. No risk assessment was performed for the identification, consideration and avoidance of potential risks in the SCM system as required in terms of regulation 41(2) of the South African Supply Chain Management Regulations.

INTERNAL CONTROL

93. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives and compliance with the MFMA, DoRA and the MSA, but not for the purpose of expressing an opinion on the effectiveness of internal control.

94. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

- **Leadership**

The municipality did not have sufficient monitoring controls to ensure adherence to the internal policies and procedures and for the purpose of taking corrective actions.

- **Financial and performance management**

Staff and consultants did not have a clear understanding of the SA Standards of GRAP and the municipality did not have adequate individuals competent in financial reporting and related matters. A GRAP implementation plan to adequately plan and phase in the GRAP implementation process was not developed.

The financial staff of the municipality was not committed and skilled to ensure that the daily financial activities were fully and correctly recorded in the records of the municipality. Management did also not ensure that adequate controls were in place to detect and correct errors in the financial records. As a result of this and a lack of oversight:

- (a) Transactions were not correctly captured and allocated on the system.
- (b) The amounts disclosed in the financial statements, general ledger and sub-ledgers differed.
- (c) Documents supporting amounts disclosed in the financial statements were not available.
- (d) A proper system of record keeping relating to journals processed on the system was not in place.
- (e) Matters reported in the prior report were not corrected.

Management also did not ensure that the applicable accounting standards were adhered to in the compilation of the financial statements and that the financial statements were adequately reviewed before submission for auditing.

Furthermore, requested information was not available and supplied without significant delay.

Management did not ensure that general information technology controls were designed to maintain the integrity of the information system and security of data.

Management did not document and approve internal policies and procedures to address the process of collection, recording, processing, monitoring and reporting on performance information as adequate performance management systems have not been implemented

- **Governance**

The municipality had not undertaken a risk assessment to assess any risks of fraud and consequently had not developed a fraud prevention plan, as required by the MFMA.

Although the municipality had an internal audit division, it was not adequate for the purposes of the audit as it was only established a month before year-end and therefore did not function during the year under review.

The audit committee did not function throughout the year.

OTHER REPORTS

Investigations

94. Investigations are being conducted by independent consulting firms on request of the entity and the premier's office. The investigations were initiated based on allegations of procurement irregularities. The investigations were still ongoing at the reporting date.

Bloemfontein

30 November 2010



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence