

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mohokare Local Municipality set out on pages XXX to XXX, which comprise statement of financial position as at 30 June 2012, the statements of financial performance, changes in net assets and cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting Officer's responsibility for the 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 the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and Division of Revenue Act of South Africa 2011 (Act No.6 of 2011) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of opinion

Receivables from exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange transactions of R862 467 (2011: R5 886 949) as disclosed in note 4 to the financial statements as supporting documentation for certain indigent consumers could not be submitted to determine whether the applicant qualifies for indigence and to determine the occurrence, accuracy and completeness of the subsidies credited to receivables for indigent consumers amounting to R229 532 (2011: R1 612 628), sufficient appropriate audit evidence as to the existence of receivables amounting to R1 751 220 for the prior year was not submitted. Furthermore a difference of R2 231 098 was noted in the prior year between the debtors system for bad debts written off for which council approval was obtained and the amount disclosed in note 4 to the financial statements. Due to the lack of information I was unable to perform alternative audit procedures to provide me with the required audit assurance with regard to receivables from exchange transactions and bad debts written off. Consequently I was unable to determine whether any adjustment relating to receivables from exchange transactions was necessary.

Sundry debtors

5. I was unable to obtain sufficient appropriate audit evidence for sundry debtors of R1 158 062 (2011: R1 156 845) as disclosed in the financial statements due to the lack of sufficient appropriate audit evidence for debit transactions with an estimated value of R497 436 processed against sundry debtors accounts. Due to a lack of information I was unable to perform alternative audit procedures. Consequently I was unable to determine the existence, rights and obligations, completeness, valuation and allocation of sundry debtors.

Accumulated surplus/(deficit)

6. I was unable to obtain sufficient appropriate audit evidence for the prior year balance of the accumulated surplus of R303 217 865 as disclosed in note 19 to the financial statements due to the lack of sufficient appropriate audit evidence for the corrections made against the accumulated surplus account as disclosed in note 36.1 to the financial statements. Furthermore, the VAT debtor in the prior year is overstated by R4 662 950 and also should have been adjusted against the accumulated surplus/deficit as disclosed in note 36.1 to the financial statements. Consequently I was unable to determine the existence, rights and obligations, completeness, valuation and allocation of accumulated surplus for the prior year as well as for the other accounts affected by the adjustments.

Property, plant and equipment

7. The valuation of property, plant and equipment of R289 711 938 (2011: R289 510 415) as per note 8 to the financial statements could not be confirmed as additions from 1 July 2009 to 30 June 2011 of R67 503 523 were not valued in line with the requirements of the South African Standards of Generally Recognised Accounting Practice, GRAP 17, *Property plant and equipment*, read in conjunction with Directive 7. Furthermore, additions for the year as disclosed in note 8 to the financial statements could not be confirmed totalling R763 344. The entity's records did not permit the performance of reasonable alternative audit procedures. Consequently, I was unable to determine the valuation and completeness of additions for property, plant and equipment.

Payables

8. I was unable to obtain sufficient appropriate audit evidence for trade and other payables of R16 796 657 (2011: R19 637 226) as disclosed in note 15 to the financial statements due to the lack of sufficient appropriate audit evidence for transactions and journals processed against the trade payables account amounting to R5 116 443. Consequently I was unable to determine the existence, rights and obligations, completeness, valuation and allocation of trade and other payables.

Long-term liabilities

9. I was unable to obtain sufficient appropriate audit evidence for long-term liabilities as per note 17 to the financial statements of R13 711 093 (2011: R10 373 709). No loan agreement could be obtained for loans of R11 649 057 (2011: R6 198 905) from the electricity service provider. I was unable to confirm the rights and ownership, existence and valuation of these loans by alternative procedures. The disclosure of and calculation of the current portion of long-term liabilities could also not be confirmed due to the limitations identified above. Consequently I was unable to determine whether any adjustment to the financial statements was necessary.

Revenue

10. I was unable to obtain sufficient appropriate audit evidence from the municipality and its electricity service provider for transactions with an estimated amount of R19 106 280 included in the amounts of service charges of R35 847 242 (2011: R28 275 180), government grants and subsidies for the prior year of R68 189 764, rental of facilities and equipment of R663 136 (2011: R656 777), fines of R157 143 (2011: R156 055) and other income of R567 172 (2011: R974 842) included in the total revenue of R120 257 072 (2011: R106 380 325) as disclosed in notes 20 to 26 of the financial statements. Furthermore, alternative procedures confirmed that the total revenue might be overstated by R2 277 798, but the amount of the overstatement could not be accurately determined due to a lack of reconciliations, supporting documentation and registers. I was unable to confirm revenue by alternative means. I was unable to obtain all the information and explanations deemed necessary to determine the occurrence, completeness, accuracy, cut off and classification of revenue of R37 234 693 (2011: R98 096 563). Consequently I was unable to determine whether any adjustment relating to revenue in the financial statements was necessary.

Expenditure

11. I was unable to obtain sufficient appropriate audit evidence from the municipality and its electricity service provider for transactions with an estimated amount of R8 376 236 included in the amounts related to bulk purchases, general expenditure, repairs and maintenance, grants and subsidies paid and contracted services amounting to R42 962 462 as disclosed in notes 27 to 35 of the financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently I was unable to determine the occurrence, completeness, accuracy, cut off and classification of expenditure of R42 962 462.
12. For the prior financial year the municipality could not provide sufficient appropriate audit evidence to support the occurrence of expenditure of R6 307 132 which includes duplicate payments of R1 270 286, duplicate recordings of R1 108 814 and expenditure of R357 575 recorded in the incorrect period. Furthermore sufficient appropriate audit evidence was not available by the electricity service provider to support the occurrence, completeness, accuracy, cut-off and classification of electricity bulk purchases of R16 136 859 for the prior financial year. The municipality's records did not permit the application of alternative procedures. Consequently I was unable to determine whether any adjustment relating to expenditure in the prior financial year was necessary.

Capital commitments

13. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of capital commitments stated at R2 333 908 (2011: R2 346 453) for commitments approved and contracted and R42 739 744 (2011: R12 407 994) for commitments approved and not yet contracted, as disclosed in note 45 to the financial statements. I was unable to confirm the completeness by alternative means. Consequently I was unable to determine whether any adjustment to capital commitment was necessary.

Irregular expenditure

14. An estimated irregular expenditure of R21 997 094 (2011: R25 093 393) was identified during the audit that was incurred due to the supply chain management (SCM) policy and SCM regulations not adhered to. This irregular expenditure was subsequently disclosed in note 43.3 to the financial statements as required in terms of section 125(2)(d) of the MFMA. Furthermore, sufficient appropriate audit evidence that management has properly identified, investigated and recorded all irregular expenditure transactions during the current and prior year could not be obtained. Due to the limitations placed on the scope of the work performed relating to expenditure and the procurement of property, plant and equipment, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness, occurrence and accuracy of irregular expenditure of R130 701 014 (2011: R108 703 920), as disclosed in note 43.3 to the financial statements.

Fruitless and wasteful expenditure

15. I could not obtain sufficient appropriate audit evidence that the municipality has properly identified, investigated and recorded all fruitless and wasteful expenditure transactions during the current and prior year of R2 363 181 (2011: R2 086 252) as disclosed in note 43.2 to the financial statements. I was unable to perform alternative audit procedures. Consequently I could not determine the completeness, occurrence and accuracy of fruitless and wasteful expenditure of R2 363 181 (2011: R2 086 252) as disclosed in note 43.2 to the financial statements.

Presentation and disclosure

16. Contrary to the requirements of Section 15(2)(d) of the MFMA, the distribution loss from water service was not disclosed in the financial statements while the electricity distribution losses amounted to R112 040 287 as disclosed in note 44.9 to the financial statements. I was unable to perform alternative audit procedures to confirm the distribution losses. Consequently I could not determine the completeness, occurrence and accuracy of distribution losses.

Cash flow statement

17. I was unable to obtain sufficient appropriate audit evidence to determine whether the cash flow statement and the related notes were fairly stated. Taking into account the misstatements and scope limitations identified in the financial statements, as set out in this report, I was unable to practically quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine the accuracy, completeness and disclosure of the cash flow statement and related notes.

Disclaimer of opinion

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

Emphasis of matter

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

Going concern

20. The statement of financial performance and the cash flow statement to the annual financial statements indicate that the Mohokare Local Municipality incurred a net loss of R17 040 532 and a net cash outflow of R2 073 970 during the year ended 30 June 2012. These conditions, along with other matters as set forth in note 46 to the financial statements, indicate the existence of an uncertainty that may cast doubt on the municipality's ability to operate as a going concern.

Restatement of corresponding figures

21. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during 2011-12 in the financial statements of the Mohokare Local Municipality at, and for the year ended 30 June 2011.

Additional matters

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

Unaudited supplementary information

23. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

24. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

25. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of the annual report.

26. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*.

The reliability of the information in respect of the selected programmes is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

27. The material findings are as follows:

Usefulness of information

28. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA), requires that the integrated development plan (IDP) should form the basis for the annual performance report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 44% (>20%) of the reported objectives, 67% (>20%) of the reported indicators and 73% (>20%) of the reported targets are not consistent with the objectives, indicators and targets as per the approved IDP. This is due to the lack of review procedures in place to ensure that the IDP and annual performance report is aligned
29. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 28% (>20%) of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principles.
30. The National Treasury *Framework for managing programme performance information* requires that performance targets be measurable. The required performance could not be measured for a total of 28% (>20%) of the targets. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principles.
31. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 24% (>20%) of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principles.
32. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 24% (>20%) of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the fact that management was aware of the requirements of the *FMPPi* but did not receive the necessary training to enable application of the principles.

Reliability of information

33. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that processes and systems which produce the indicator should be verifiable. A total of 33% (>20%) of the actual reported performance relevant to the selected programmes was not valid and accurate when compared to the source information and evidence provided. This was due to the municipality not implementing a proper performance management system.

34. The National Treasury *Framework for managing programme performance information (FMPPi)* requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the accuracy of the actual reported performance relevant to 33% (>20%) of selected objectives. This was due to the municipality not implementing a proper performance management system.

Additional matter

35. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

36. Of the total number of 55 targets planned for the year, 22 targets were not achieved during the year under review. This represents 40% (>20%) of total planned targets that were not achieved during the year under review.

Compliance with laws and regulations

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

Strategic planning and performance management

38. The council did not adopt in good time, a process set out in writing to guide the planning, drafting, adoption and review of its IDP, as required by section 28(1) of the MSA.
39. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.

Annual financial statements, performance and annual report

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected.

Internal audit

41. The municipality did not establish a functioning internal audit unit as required by section 165(1) of the MFMA.
42. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).
43. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators], as required by Municipal Planning and Performance Management Regulation 14(1)(b) [(i) / (ii) / (iii)].

44. The internal audit unit did not audit the performance measurements on a continuous basis and/or submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14(1)(c).

Procurement and contract management

45. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers, as required by municipal SCM regulation 17(a) and (c). (Ex.136)
46. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as per the requirements of SCM regulation 19(a) and 36(1). (Ex159)

Human resource management and compensation

47. The acting senior managers directly accountable to the municipal manager did not have performance agreements, as required by section 57(2)(a) of the MSA. (Ex.36)

Revenue management

48. An adequate management, accounting and information system was not in place which recognised revenue when it was earned and accounted for debtors, as required by section 64(2)(e) of the MFMA.
49. Interest was not charged on all accounts in arrears as, required by section 64(2)(g) of the MFMA.

Conditional grants received

50. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
51. Projects were not implemented in line with the details contained in the IDP, as required by the Division of Revenue Grant Framework, Gazette No.34280.

Budget

52. Expenditure was incurred that was not budgeted for and in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Financial misconduct

53. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA due to the fact that irregular and fruitless and wasteful expenditure was incurred but was not investigated.

Expenditure management

54. The accounting officer did not take reasonable steps to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.
55. Sufficient appropriate audit evidence could not be obtained that money owing by the municipality had always been paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

Asset management

56. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained a management, accounting and information system which accounts for the assets of the municipality as required by section 63(2)(a) of the MFMA.

Internal control

57. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

58. The leadership did not effectively evaluate whether management had implemented effective internal controls. They did not gain a comprehensive understanding of how senior management members had met their responsibilities in terms of ensuring proper record management in respect of preparing the annual financial statements.
59. The leadership did implement the necessary controls to prevent non compliance to the SCM regulations and took the necessary action to address the lack of discipline in the finance and SCM directorates; however this still resulted in non-compliance to the procurement legislation which in turn gave rise to the high levels of unauthorised, fruitless and wasteful and irregular expenditure incurred in the financial statements.
60. The leadership of the municipality did not effectively develop, implement and monitor internal control procedures to ensure that quarterly financial statements are prepared and subjected to review. This oversight resulted in the challenges faced to submit financial statements to audit that are fully compliant to the SA Standards of GRAP and necessitated the amendment of financial statements provided for audit purposes.
61. The leadership partly implemented controls to ensure compliance with laws, regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted.

Financial and performance management

62. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented.
63. Due to oversight on the part of the accounting officer, the regular review and monitoring of compliance to laws and regulations were not sufficiently prioritised in the municipality. As a result, significant non-compliance issues were noted that could have been prevented.

64. The staff within the finance directorate of the municipality lacked the appropriate skill and competence and this necessitated the municipality to make use of consultants to supplement such constraints. Consultants assisted with the preparation of an asset register and the preparation of the financial statements.
65. Due to time pressure brought about by the fact that the process of preparing the financial statements were only started late in the financial year, when appointment of the consultants were finalised sufficient time was not available to the chief financial officer to properly review such statements for completeness and accuracy prior to submission thereof for auditing. This resulted in many findings relating to incorrect disclosure which were subsequently corrected.
66. Staff within the finance directorate of the municipality had an insufficient understanding of the accounting framework. This contributed towards the numerous errors that were subsequently corrected in the financial statements of the municipality.

Governance

67. Management did not establish a functioning internal audit unit.

OTHER REPORTS

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

Auditor-General

Bloemfontein

30 November 2012



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence