

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

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I was engaged to audit the accompanying financial statements of the Matjhabeng Local Municipality which comprise the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages xx to xx.

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

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

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Matjhabeng Local Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

**Basis for disclaimer of opinion**

**Property, plant and equipment**

5. The municipality was unable to provide me with an updated asset register. Consequently, I was not able to verify that items of property, plant and equipment of R670 918 379 (30 June 2008: R569 161 875) as disclosed in note 9 to the financial statements, were accounted for at the correct value, that these items did exist at year-end, that the municipality had control over these items and that the balance reflected in the financial statements includes all the municipality's items of property,



plant and equipment. The system of control over items of property, plant and equipment was not sufficient to provide me with alternative means to perform my audit on these items.

### **Consumer debtors**

6. The municipality was unable to provide me with sufficient appropriate audit evidence regarding non-current consumer debtors of R6 774 823 as disclosed in note 10 to the financial statements. Consequently, I was unable to verify that these debtors did exist at year-end, that they were accounted for at the correct value in the financial statements of the municipality, that the balance outstanding is payable to the municipality and that the balance of R6 774 823 includes all the municipality's non-current receivables.
7. Contrary to a council resolution, the municipality wrote off debts older than 300 days instead of only debts older than three years. Based on my calculations, debts written off (impairment loss) are overstated and consumer debtors understated by R227,8 million.
8. Indigent applications for a sample of consumer debtors could not be submitted for audit purposes. In the absence of these applications, I could not verify the status of these consumer debtors as indigent. Consequently, I have assessed the possible understatement in service and rates income and receivables at approximately R19 million due to the incorrect classification of these consumer debtors as indigent.
9. I could not be supplied with sufficient and appropriate audit evidence that the municipality has assessed the recoverability (impairment) of its consumer and other debtors in terms of the requirements of the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement*. The municipality only made a general provision based on the ageing of the outstanding debt. Consequently, I was unable to determine the impact of non-compliance with this accounting standard on the financial statements as well as the accuracy of the provision of doubtful debts of R509 651 241.
10. I could not verify the existence of all consumer debtors of R90 147 393 as disclosed in note 7 to the financial statements. In the absence of payments made after year-end as well as service contracts and indigent applications, I could not verify that these debtors do exist.

### **Trade and other payables**

11. Contrary to the Statement of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements*, the municipality did not account for retention money on capital projects. Based on the total payments made for the past two financial years, I have assessed the possible understatement in the disclosed property, plant and equipment balance (work-in-progress) as well as trade and other payables at R39 million.
12. Included in payables is an amount of R30 727 009 provided for creditors on capital projects. I was unable to gain adequate audit assurance by means of audit procedures I considered necessary or by alternative means as to the existence and valuation of this balance at year-end due to inadequate supporting documentation submitted for audit purposes.



## **Expenditure**

13. Contrary to the Statement of Generally Recognised Accounting Practice: GRAP 1, *Presentation of Financial Statements*, the municipality recognised internal charges of R15 318 530 (30 June 2008: R15 845 285). These charges do not represent an outflow or consumption of assets or increase in liability, resulting in an overstatement of operating expenditure and service charges income.
14. Documentation to support expenditure transactions of R12 742 428 could not be submitted for audit purposes. The system of control over the recording and classification of expense transactions was not adequate and as a result there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all these expense transactions had occurred and were correctly and accurately recorded and classified in the financial records of the municipality.
15. In the absence of an updated fixed asset register, I was unable to verify the correctness of depreciation and amortisation charges of R15 517 932 (30 June 2008: R9 505 993) as disclosed in note 28 to the financial statements.

## **Taxes and transfers payable**

16. The municipality is registered on the payment basis for VAT purposes, resulting in a difference of R110 246 584 between the VAT201 return for June 2009 and the liability as disclosed in note 14 to the financial statements. The municipality was unable to reconcile this difference and in the absence of sufficient appropriate audit evidence I was unable to confirm the valuation of this payable at year-end.

## **Commitments**

17. The municipality was unable to provide me with sufficient appropriate audit evidence regarding commitments of R22 423 155 as disclosed in note 38 to the financial statements. In the absence of contracts entered into between the municipality and third parties, I was unable to verify the existence, valuation and completeness of this amount as well as the municipality's obligation in this regard.

## **Employee benefits**

18. The South African Statement of Generally Accepted Accounting Practice, IAS 19, (AC116) *Employee Benefits*, outlines the recognition and disclosure requirements pertaining to post-employee benefit plans. Contrary to these requirements, the municipality did not make any disclosure regarding the liability at year-end in terms of their post-employment benefit plan. In the absence of an actuarial valuation, I was unable to gain adequate audit assurance as to the valuation of the liability at reporting date and could consequently not determine the misstatement.

## **Inventory**

19. Contrary to the requirements of the Statement of Generally Recognised Accounting Practice, GRAP 12, *Inventories*, the municipality did not account for vacant residential sites at year-end as inventory in their financial statements. In the absence of a property register and property valuation rolls for the municipality I was unable to quantify the extent of misstatement in the financial statements.

### **Investment properties**

20. Contrary to the requirements of the Statement of Generally Recognised Accounting Practice, GRAP 16, *Investment Property*, the municipality did not separately account for investment properties in their financial statements. In the absence of an updated asset register I was unable to quantify the extent of the misstatement in the financial statements of the municipality.

### **Provisions**

21. I could not be supplied with sufficient appropriate audit evidence that the provision for environmental rehabilitation of R2 423 073 (30 June 2008: R2 042 087) as disclosed in note 17 to the financial statements was complete. Furthermore, the municipality did not disclose assumptions made regarding the provision as required by Statement of Generally Recognised Accounting Practice, GRAP 19, *Provisions, Contingent liabilities and Contingent assets*.

### **Disclaimer of opinion**

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

### **Emphasis of matters**

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

#### **Going concern**

23. In note 43 it is disclosed that the ability of the municipality to continue as a going concern is dependent on a number of factors, including the need to obtain funding on a continuous basis.

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

24. As disclosed in note 45 to the financial statements, the municipality incurred unauthorised expenditure of R175 116 024 (30 June 2008: R389 511 751) during the year under review due to inadequate budgetary control measures.
25. As disclosed in note 46 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R20 203 680 (30 June 2008: R2 444 167) during the year under review due to the municipality's inability to pay their creditors on time.
26. As disclosed in note 47 to the financial statements, the municipality incurred irregular expenditure of R71 726 349 (30 June 2008: R41 979 974) during the year under review due to an inadequate procurement process.

### **Restatement of corresponding figures**

27. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of correcting my prior year audit findings during the current year in the financial statements of the Matjhabeng Local Municipality at, and for the year ended 30 June 2008.



## **Other matters**

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

## **Unaudited supplementary schedules**

28. The supplementary information set out on pages 63 to 65 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**

29. Contrary to the requirements of section 69(3) of the MFMA, the accounting officer did not submit within 14 days after the budget was approved the draft service delivery and budget implementation plan as well as drafts of the annual performance agreements to the mayor.
30. All money owing by the municipality was not paid within 30 days of receiving the relevant invoice or statement. Various payments were not paid within the prescribed time frame as is required by section 65(2)(e) of the MFMA.
31. Contrary to section 17(1)(a) of the MFMA, the municipality did not budget for income from agency fees. The total income received in this regard amounted to R6 904 586 for the year under review.
32. It was noted that the municipality has written off debt of R870 million during the financial year under review. This indicates that the municipality has not complied in all respects with section 64(2) of the MFMA, which requires that the municipality should implement an effective revenue collection system.
33. Proof could not be obtained that the performance agreements of the municipal manager and senior managers were made public no later 14 days after the approval of the municipality's service delivery and budget implementation plan and that copies of such performance agreements were submitted to the council and the MEC for Local Government in the province as required by section 53(3)(b).
34. Contrary to section 132(1)(b) of the MFMA proof could not be obtained that the oversight report which was adopted by the council was submitted to the provincial legislature.
35. Contrary to section 32(4)(a) of the MFMA, proof could not be obtained that the accounting officer promptly informed the mayor, the MEC for Local Government in the province and the Auditor-General, in writing, of any unauthorised, irregular or fruitless and wasteful expenditure incurred by the municipality.
36. The council of the municipality did not adopt an oversight report within two months from the date on which the annual report was tabled in the council, as in required by section 139(1) of the MFMA.
37. Proof could also not be obtained that the oversight report was made public within seven days of its adoption, as in required by section 139(3) of the MFMA.

38. The annual report of the municipality for the 2007-08 financial year did not include particulars of any corrective action taken or to be taken in response to the issues raised in the audit report, as in required by section 121(3)(g) of the MFMA.

#### **Municipal Structures Act**

39. Contrary to the requirements of section 14(2)(b)(iii), three bank accounts were identified that have not been registered in the name of the Matjhabeng Local Municipality, but were still registered in the name of the previous transitional local councils.

#### **Municipal Systems Act**

40. Employment contracts for two persons appointed as managers directly accountable to the municipal manager could not be submitted for audit purposes, which is contrary to section 57(1)(a).

#### **Division of Revenue Act**

41. The municipality has not, within two months after the end of the financial year, evaluated its performance in respect of programmes or functions funded or partially funded by an allocation in terms of this act, as required by section 12(6).

#### **Governance framework**

42. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

#### **Internal control deficiencies**

43. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control (the number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
5	Property, plant and equipment	5			2,3	
6 – 10	Consumer debtors	5	2	3	3	3
11 – 12	Trade and other payables	5	2	3		3
13 – 15	Expenditure	5	2			3
16	Taxes and transfers payable		2	3		
17	Commitments	5		3		3
18	Employee benefits		2	3	2	
19	Inventory	5	2		2	

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20	Investment properties	5			2	
21	Provisions		2	3		

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

44. The municipality only commenced with a process to address prior year audit findings after year-end. The qualifications emanated from a combination of factors including the following:

- There was a high turnover of staff in the finance section, resulting in vacancies within this section as well as a high number of people in acting positions.
- The chief financial officer resigned just before year-end, which hampered the process of compiling the financial statements.
- The current system in place to account for the municipality's assets is not affective and does not provide the necessary information which will enable compliance with the reporting standards relating to assets. It was also noted that most of the internal processes and systems followed by the municipality were not adjusted to conform to the new reporting requirements.
- The municipality experienced severe cash flow constraints during the year under review, which not only hampered the filling of vacancies but, also resulted in the postponement of the appointment of consultants to update the asset register.

Legend	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3



<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self -assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

45. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
<b>Quality of financial statements and related management information</b>			
2	The financial statements were not subject to any material amendments resulting from the audit.		X
3	The annual report was submitted for consideration prior to the tabling of the auditor's report.	X	
<b>Timeliness of financial statements and management information</b>			
4	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	X	
<b>Availability of key officials during audit</b>			
5	Key officials were available throughout the audit process.	X	
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6	Audit committee		
	• 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	
12	Delegations of responsibility are in place, as set out in section 79/106 of the MFMA.	X	
<b>Follow-up of audit findings</b>			
13	The prior year audit findings have been substantially addressed.		X
14	SCOPA/Oversight 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 Matjhabeng Local Municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68 of the MFMA.		X
18	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

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

46. Sufficient and appropriate audit evidence could not be provided during the audit, due to a culture of non-retention of supporting documentation at the municipality. The financial statements were subject to material adjustments arising from the audit, due to an independent quality review not being conducted before submission for audit purposes, as well as the fact that the chief financial officer resigned at year-end and consequently a chief financial officer was not involved in this process.
47. The audit committee members were not appointed during the year and for the majority of the year the internal audit section functioned with only one staff member, resulting in the municipality not being able to comply with the requirements of the MFMA in this regard.
48. The process to address prior year audit findings only commenced subsequent to year-end with the appointment of consultants to assist the municipality in this regard and consequently there was not enough time available to clear all outstanding matters prior to the submission of the financial statements for audit purposes.

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

### **Report on performance information**

49. I was engaged to review the performance information.

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

50. 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**

51. 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.

52. 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.

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

### **Findings on performance information**

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

54. Proof could not be obtained that the municipality's integrated development plan and subsequent amendments to the plan were submitted within 10 days of the adoption thereof to the MEC for Local Government in the province as is required by section 32(1)(a) of the MSA.
55. Contrary to section 40 of the MSA, proof could not be obtained that the municipality has established mechanisms to monitor and review its performance management system.
56. Proof could not be obtained that the municipality gave notice to the public of the adoption of its integrated development plan as is required by section 25(4)(a)(i) of the MSA.
57. Contrary to the requirements of section 26(h) of the MSA, read with Regulation 2(3) of the Local Government: Municipal Planning and Performance Regulations, 2001, the integrated development plan of the municipality did not reflect a financial plan.
58. Contrary to Regulation 6 of the Municipal Planning and Performance Regulations, 2001, we could not confirm that the municipality's integrated development plan informed the municipality's annual budget that must be based on the development priorities and objectives referred to in section 26(c) of the MSA and the performance targets set by the municipality in terms of regulation 12.



59. Contrary to the requirements of section 53(1)(c)(iii) of the MFMA, the municipality's service delivery budget implementation plan was not approved within 28 days after the approval of the budget.
60. Proof could not be obtained that the municipality has, in terms of its performance management system, monitored performance and measured and reviewed the performance of each development priorities and objectives against the key performance indicators and targets as is required by section 41(1)(c) of the MSA.

#### **Performance information not received in time**

61. 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**

62. The assistance rendered by the staff of the Matjhabeng Local Municipality during the audit is sincerely appreciated.

*Auditor - General*

Bloemfontein

15 January 2010



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*