

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ~~xx~~ to ~~xx~~.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). 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 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these 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

Property, plant and equipment

4. Due to the matters listed below, I was not able to verify that items of property, plant and equipment of R876 346 011 (30 June 2009: R759 075 783) as disclosed in note 8 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:
 - a) For assets with a carrying value of R860 742 742 (30 June 2009: R730 377 351) the descriptions, serial numbers and locations of these items as indicated in the fixed asset register were inadequate for identification purposes. Consequently, I was unable to perform all the procedures I considered necessary to obtain adequate audit assurance as

to the existence, valuation, completeness, presentation and disclosure of and the municipality's rights to property, plant and equipment to this amount.

- b) Documentation to support additions of R18 142 821 to property, plant and equipment could not be submitted for audit purposes. In the absence of these documents, I was unable to confirm the valuation and existence of these items purchased.
- c) Immovable properties of R10 578 405 which conform to the definition and recognition criteria of property, plant and equipment as stated in paragraphs 10 and 11 of the SA Standard of GRAP, GRAP 17, *Property, plant and equipment* and which were identified as municipal property on the valuation roll, were not included in the fixed asset register. In the absence of an updated property valuation roll for the municipality, I was unable to determine the extent of the misstatement in the disclosed property, plant and equipment balance.
- d) Contrary to paragraph 61 of the SA Standard of GRAP 17, *Property, plant and equipment* proof could not be obtained that the residual values and the useful lives of assets were reviewed at reporting date and, if expectations differ from previous estimates, the changes were accounted for as a change in an accounting estimate in accordance with the SA Standard of GRAP 3, *Accounting policies, changes in accounting estimates and errors*.
- e) Paragraph 19 of the SA Standard of GRAP, GRAP 26, *Impairment of cash-generating assets* requires that property, plant and equipment should be assessed for impairment at each reporting date. Management did not assess whether there was a decrease in the value of property, plant and equipment during the financial year under review. Consequently, I could not obtain adequate audit assurance as to the valuation of the municipality's property, plant and equipment.
- f) Paragraph 53 of the SA Standard of GRAP 17, *Property, plant and equipment* requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. The municipality has not complied with these requirements. Consequently, I could not obtain adequate audit assurance as to the valuation of property, plant and equipment and the accuracy of depreciation charges as disclosed in note 8 to the financial statements.
- g) Several assets identified at the premises of the municipality could not be traced to the fixed asset register of the municipality. Therefore, the completeness of the assets disclosed could not be confirmed.

Consumer debtors

- 5. The municipality was unable to provide me with sufficient appropriate audit evidence regarding non-current consumer debtors of R6 413 795 (30 June 2009: R33 246 463) as disclosed in note 9 to the financial statements. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all non-current debtors were properly accounted for. 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 413 795 (30 June 2009: R33 246 463) includes all the municipality's non-current receivables.
- 6. Contrary to a resolution taken by the council of the municipality, debts of R227,8 million was incorrectly written off in the prior year. During the financial year under review, the municipality incorrectly wrote off an additional R21,5 million, which was also based on this

resolution. Based on my calculations, debts written off (impairment loss) are overstated and consumer debtors understated by R249,3 million (30 June 2009: R227,8 million).

7. Approved 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 and there were also no satisfactory alternative audit procedures I could perform to confirm the status of these debtors as indigent. Consequently, I have assessed the possible understatement in service and rates income and consumer debtors at R69,2 million (30 June 2009: R19 million) due to the incorrect classification of these consumer debtors as indigent.
8. 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 R689 626 064 (30 June 2009: R509 651 243) and on the impairment loss of R208 760 412 (30 June 2009: R297 576 133).
9. I could not verify the existence of consumer debtors of R13 899 534 (30 June 2009: R88 805 483) as disclosed in note 6 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 did exist at year-end.
10. Contrary to the accrual basis of accounting, as outlined in the SA Standard of GRAP, GRAP 1, *Presentation of financial statements*, the municipality closed off the financial systems seven days after financial year-end, resulting in an understatement of the accumulated surplus of R1,450 million and consumer debtors of R8,030 million and an overstatement of cash and cash equivalents of R8,200 million, payables of R0,910 million and VAT payable of R0,710 million.

Trade and other payables

11. Contrary to the SA Standard of GRAP, GRAP 1, *Presentation of financial statements*, the municipality did not account for retention monies. Based on my calculations, I have assessed the understatement in the disclosed trade and other payables as well as property, plant and equipment balance (work-in-progress) at R16,7 million (30 June 2009: R39,0 million). Due to sufficient supporting documentation not being available, I was unable to assess the impact of the above on government grant income and unspent conditional grants.

Expenditure

12. The municipality could not provide sufficient appropriate audit evidence to support expenditure transactions of R258,5 million (30 June 2009: R12,7 million). 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.
13. In the absence of an updated fixed asset register, and due to the matters mentioned in paragraph 7, I was unable to verify the occurrence, accuracy, classification and

completeness of depreciation and amortisation charges of R28 890 271 (30 June 2009: R23 890 271) as disclosed in note 28 to the financial statements.

Irregular expenditure

14. Section 125(2)(d)(i) of the MFMA requires the municipality to disclose in a note to the financial statements any material irregular expenditure and regulation 36(2) of the Supply Chain Management Regulations requires the municipality to disclose in a note to the financial statements the reasons for any deviations in terms of sub-regulation (1)(a) and (b). Due to the limitations placed on my audit of expenditure and procurement management at the municipality, I was unable to confirm the completeness of the disclosure made in note 46 to the financial statements.

Government grants and subsidies income

15. A difference of R40 690 000 relating to in-kind allocations according to DoRA and the amounts accounted for as unspent conditional grants and receipts (received during the year), as disclosed in note 16, could not be substantiated by the municipality, indicating a possible understatement of the unspent conditional grants and receipts as well as a possible understatement in trade and other receivables and work-in-progress.
16. Paragraph 43 of the South African Standards of Generally Accepted Municipal Accounting Practice, GAMAP 9, *Revenue* states that government grants are recognised as revenue to the extent that there has been compliance with any restriction associated with the grant. Documentation to support expenditure transactions of R34 525 406 and agreements entered into between the municipality and provincial government departments for payments of R46 441 454 could, however, not be submitted for audit purposes. In the absence of these documents and agreements, I was unable to verify that government grant and subsidy income of R72 116 154 as included in note 23 complied with the recognition requirements as outlined in GAMAP 9 and could consequently not determine the impact of this on the unspent conditional grants and receipts liability.

Unauthorised expenditure

17. In terms of chapter 1 of the MFMA, unauthorised expenditure is defined as expenditure incurred by a municipality otherwise than in accordance with section 15 of the act and includes spending of an allocation otherwise than in accordance with any conditions of the allocation. Based on the limitations placed on my audit of government grants and subsidies income as noted in paragraph 17 above, I am unable to conclude on the completeness of the unauthorised expenditure balance of R216 155 588 as disclosed in note 44 to the financial statements, as required by section 125(2)(d) of the MFMA.

Commitments

18. The municipality was unable to provide me with sufficient appropriate audit evidence regarding commitments of R84 831 949 (30 June 2009: R22 243 155) as disclosed in note 38 to the financial statements. In the absence of contracts entered into between the municipality and third parties as well as an updated contract register, 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

19. 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 account for its post-employment benefit plans in its financial statements. In the absence of actuarial valuations, I was unable to gain adequate audit assurance as to the valuation of the liability at reporting date and could consequently not determine the effect on the other account balances and classes of transactions contained in the financial statements.

Inventory

20. Contrary to the requirements of the SA Standard of GRAP 12, *Inventories*, the municipality did not account for vacant residential sites as inventory in their financial statements. In the absence of a property register and updated property valuation rolls for the municipality I was unable to quantify the extent of misstatement in the current year's as well as the corresponding disclosed inventory balance.

Investment properties

21. Contrary to the requirements of the SA Standard of GRAP 16, *Investment property*, the municipality did not separately account for investment properties in their financial statements. In the absence of a property register and updated property valuation rolls for the municipality I was unable to quantify the extent of the misstatement in the financial statements.

Provisions

22. I could not be supplied with sufficient appropriate audit evidence regarding the provision for environmental rehabilitation of R72 606 272 (30 June 2009: R59 661 353) as disclosed in note 17 to the financial statements. In the absence of sufficient appropriate audit evidence, I was unable as to confirm the valuation and completeness of this liability at year-end as well as the accuracy and completeness of the movement of R12 944 919, as included in the general expenses. Furthermore, the municipality did not disclose assumptions made regarding the provision as required by the SA Standard of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*.

Disclaimer of opinion

23. 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

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

Going concern

25. As disclosed in note 42, the ability of the municipality to continue as a going concern is dependent on a number of factors, including the need to obtain funding on a continuous basis.

Unauthorised, irregular and fruitless and wasteful expenditure

26. As disclosed in note 44 to the financial statements, the municipality incurred unauthorised expenditure of R216 155 588 (30 June 2009: R175 116 024) during the year under review due to inadequate budgetary control measures.
27. As disclosed in note 45 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R14 171 466 (30 June 2009: R20 203 680) during the year under review due to the municipality's inability to pay their creditors on time.
28. As disclosed in note 46 to the financial statements, the municipality incurred irregular expenditure of R14 391 539 (30 June 2009: R71 726 349) during the year under review due to inadequate procurement processes followed.

Restatement of corresponding figures

29. As disclosed in note 40 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of correcting prior year audit findings during the current financial year in the financial statements of the Matjhabeng Local Municipality at, and for the year ended, 30 June 2009.

Additional matter

30. I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

31. The supplementary information set out on page 57 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

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

Predetermined objectives

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

Non-compliance with regulatory requirements

Existence and functioning of a performance audit committee

34. The Matjhabeng Local Municipality did not have a functioning performance audit committee as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Approval of the service delivery budget implementation plan

35. Contrary to the requirements of section 53(1)(c) of the MFMA, the municipality's 2009-10 service delivery budget implementation plan was not approved within 28 days after the approval of the budget.
36. Contrary to the requirements of section 54(1)(c) of the MFMA, the municipality's 2009-10 service delivery budget implementation plan was not revised after the council approved adjustments to the capital budget.

No mid-year budget and performance assessments

37. Contrary to the requirements of section 72(1)(a) of the MFMA, management did not report on 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 well as on the past year's annual report and progress on resolving problems identified in the annual report.

Inadequate content of integrated development plan

38. 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.
39. Proof could not be obtained that the municipality's 2009-10 integrated development plan was 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.

Lack of implementation of a performance management system

40. 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.

Inadequate presentation of reported information

41. Contrary to the requirements of section 46(1)(b) of the MSA, proof could not be obtained that the performance report included a comparison of the performances with targets set for and performances in the previous financial year.

Usefulness of reported performance information

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

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development 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:

Reported information not consistent with planned objectives, indicators and targets

42. The municipality has not reported throughout on its performance against predetermined objectives, indicators and targets which are consistent with the approved integrated development plan. None of the reported indicators and targets reported on in the performance report could be link with the integrated development plan.

Reported indicators/measures not well defined

43. For the selected directorate infrastructure, 49% (37 of 75) of the reported indicators/measures were not clear, with an ambiguous definition to allow for data to be collected consistently.

Planned performance targets not time bound

44. For the selected directorate infrastructure, 70% (100 of 142) of the planned indicators'/measures' performance targets were not set which were time bound and therefore the time period or deadline for delivery was not specified.

Reliability of reported performance information

The following criteria were used to assess the reliability of the planned and reported performance:

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

The following audit finding relates to the above criteria:

No supporting source documentation

45. Sufficient appropriate audit evidence in relation to the directorate infrastructure could not be obtained. There were also no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information.

Compliance with laws and regulations

Municipal Finance Management Act

The audit committee was not properly established

46. Contrary to section 166 of the MFMA, the municipality did not have a functioning audit committee for the year under review.

Expenditure was not paid within the parameters set by the MFMA

47. All money owing by the municipality was not paid within 30 days of receiving the relevant invoice or statement. Various payments were not made within the prescribed time frame as is required by section 65(2)(e) of the MFMA.

The accounting officer did not adhere to his statutory responsibilities

48. It was noted that the municipality has written off debt of R1 076 million during the past four financial years 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.
49. 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.

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

50. Contrary to section 62(1)(d) of the MFMA, the accounting officer of the municipality did not take all reasonable steps to ensure that irregular expenditure are prevented. As disclosed in note 46 to the financial statements, the municipality incurred irregular expenditure of R11 503 497 during the year under review.

Expenditure incurred could have been avoided resulting in fruitless and wasteful expenditure

51. Contrary to section 62(1)(d) of the MFMA, the accounting officer of the municipality did not take all reasonable steps to ensure that fruitless and wasteful expenditure are prevented. As disclosed in note 45 to the financial statements, the municipality incurred irregular expenditure of R14 171 466 during the year under review.

Expenditure was incurred otherwise than in accordance with sections 15 of the MFMA resulting in unauthorised expenditure

52. Contrary to section 62(1)(d) of the MFMA, the accounting officer of the municipality did not take all reasonable steps to ensure that unauthorised expenditure are prevented. As disclosed in note 44 to the financial statements, the municipality incurred irregular expenditure of R216 155 588 during the year under review.

Supply chain management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

53. In the absence of signed attendance registers for the bid adjudication committee, compliance with section 117 of the MFMA could not be confirmed. (Ex. 239)

Municipal Systems Act

Supply chain management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

54. Contrary to schedules 1 and 2 of this act, proof could not be obtained that councillors and staff members declared their interests as required by this act.

Supply chain management regulations

Supply chain management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

55. Contrary to regulation 3, proof could not be obtained that the accounting officer of the municipality reviewed the implementation of the supply chain management policy of the municipality during the year under review.
56. Proof could not be obtained that the reporting requirements of the following regulations were complied with: regulations 5(3), 5(4), 17(2) and 18(d).

INTERNAL CONTROL

57. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the following key legislation: MFMA, MSA and DoRA but not for the purpose of expressing an opinion on the effectiveness of internal control.
58. 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

59. The accounting officer did not exercise oversight responsibility over reporting and compliance with laws and regulations and internal control. Accountability to the public is not emphasised.

Financial and performance management

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

Governance

61. The entity does not identify risks relating to the achievement of financial and performance reporting objectives. An audit committee was not functioning during the year under review. Ongoing monitoring and supervision was not undertaken to enable an assessment of the effectiveness of internal control over financial and performance reporting.

OTHER REPORTS

Investigations

62. An independent consulting firm was appointed by the municipality to conduct an investigation into various aspects at the municipality. At the time of completing my audit, a final report was not yet available.

Auditor-General
Bloemfontein

30 November 2010



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