

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF THE NGWATHE 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 Ngwathe Local Municipality which comprise the statement of financial position as at 30 June 2009, 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 notes, as set out on pages [X] to [X].

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 Standards of Generally Recognised Accounting Practice 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 these 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 Ngwathe 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. Property, plant and equipment with a carrying value of R553 366 067 (2008: R476 043 506) is presented in the statement of financial position and disclosed in

note 1 to the financial statements. I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of, and rights to property, plant and equipment, as a result of the following:

- (a) The municipality did not maintain a fixed asset register, as required by section 63(2)(c) of the MFMA. Consequently, I was unable to physically verify or determine the rights, completeness and valuation of items of property, plant and equipment.
- (b) During the year, the municipality disposed of assets for proceeds of R1 412 574. I was unable to obtain sufficient appropriate audit evidence to support the disposals. In addition, because the municipality did not maintain a fixed asset register as described above, I was also unable to determine the carrying value of the disposed assets and could not confirm whether the loss on disposal of assets amounting to R1 080 623 disclosed in note 32 is materially misstated.
- (c) Management could not provide me with sufficient appropriate audit evidence to confirm the valuation of additions to property, plant and equipment amounting to R1 899 020 in the prior year (2007: R21 142 972). These items of property plant and equipment are still included at these values in the year-end carrying value.

There were no alternative procedures I could perform in order to obtain the audit evidence I required.

6. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatements were identified:

- (a) Capital expenditure amounting to R7 574 849 incurred by the Fezile Dabi District Municipality on behalf of the Ngwathe Local Municipality was not recorded in the accounting records of the municipality, resulting in an understatement of current year additions and donated property, plant and equipment income.
- (b) Property, plant and equipment purchased in the prior year amounting to R25 617 769 was recorded and disclosed as additions to property, plant and equipment in the current year. Included in the R25 617 769 is prior year additions amounting to R1 620 175 which have been recorded again as additions in the current year. Accordingly, current year additions to property plant and equipment disclosed in note 1 is overstated by R25 617 769. The incorrect timing of the recording of additions to property, plant and equipment resulted in the overstatement in the current year of donated property plant and equipment income by R19 856 395 and current year government grants and subsidies and deferred income by R163 948 and R4 175 055, respectively.
- (c) Property, plant and equipment is understated by R1 746 837 as a Value Added Tax (VAT) input of R742 267 was claimed on invalid VAT invoices in terms of section 20 of the VAT Act and assets received from Fezile Dabi District Municipality during the current year were understated by R1 004 570.

Accounts receivable

7. Consumer receivables from exchange transactions and other receivables from non-exchange transactions amounting to R158 474 398 (2008: R69 240 157) are presented in the statement of financial position. I was unable to obtain sufficient

appropriate audit evidence to confirm the valuation and existence of these debtors and related revenue as a result of the following:

- (a) International Financial Reporting Standards, IAS39: *Financial Instruments: Recognition and Measurement* (IAS39) requires management to assess whether there is any objective evidence that a financial asset is impaired and, if so, to calculate the amount of the impairment. A significant number of consumer debtors had exceeded their credit terms at year-end. The municipality only made a general provision for doubtful receivables. Due to a lack of supporting documentation, I was unable to determine what the impairment charge should have been had IAS39 been applied correctly.
- (b) Suspense accounts included in accounts receivable amounting to R4 852 059 (2008: R19 924 884) were not cleared at year-end by management as required by section 65(2)(j) of the MFMA. I was unable to obtain evidence to support the transactions included in the suspense accounts.
- (c) During the year, management posted various journal entries to accounts receivable, revenue and VAT receivable. Journal entries with debits of R19 377 238 and credits of R19 885 842 were posted to accounts receivable; debits of R17 762 935 and credits of R17 416 561 were posted to revenue; and debits of R1 981 789 and credits of R1 819 559 were posted to VAT receivable. I was unable to obtain sufficient appropriate audit evidence to support the occurrence and accuracy of these journal entries.

There were no alternative procedures I could perform in order to obtain the audit evidence I required.

- 8. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatement was identified:
 - (a) Customers with credit balances amounting to R10 298 926 were incorrectly classified as consumer debtors in the financial statements for the year ended 30 June 2009. Accordingly, consumer debtors and other payables are understated by this amount.
 - (b) My report was modified in the prior year in respect of consumer receivables from exchange transactions for the prior year as presented on the statement of financial position and disclosed in note 6 to the financial statements. Included in debtors at 30 June 2008 were water and electricity consumption overcharges amounting to R2 347 272. These overcharges were not corrected during the previous financial year. As a result, debtors at 30 June 2008 and revenue for the year then ended were overstated by the amount of the overcharge.

Cash and cash equivalents

- 9. I was unable to obtain sufficient appropriate audit evidence to support outstanding deposits amounting to R1 972 849 identified on the bank reconciliation. There were no alternative procedures I could perform in order to obtain audit evidence that the bank balance of R1 103 323 presented in the statement of financial position was correctly valued.
- 10. In addition to the inability to obtain sufficient appropriate audit evidence, the bank reconciliation reflected cheques amounting to R4 584 838 which were cancelled prior to

year-end. The amounts owing were subsequently paid via EFT, but the municipality's records were not updated to reverse the original cheque payment and a duplicate payment was recorded. Consequently, at year-end the bank balance is understated by the same amount, VAT receivable overstated by R3 966 495, payables from exchange transactions are understated by R463 843 and expenses are overstated by R154 500.

11. My report was modified in the prior year in respect of a difference amounting to R2 199 084 identified on the bank reconciliation. I was unable to obtain sufficient appropriate audit evidence to support the difference and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that the bank overdraft of R9 537 883 at 30 June 2008 in the statement of financial position was correctly valued.

Finance lease liabilities and operating leases

12. I was unable to obtain all of the lease agreements I requested. In the absence of the lease agreements I was unable to obtain sufficient appropriate audit evidence as to the completeness of the operating lease expense amounting to R1 326 664, disclosed as rent/hire—office equipment in note 32 to the financial statements and the completeness of the finance lease liability amounting to R1 838 257 as disclosed in the statement of financial position. I was also unable to determine if the municipality appropriately classified leases as either finance or operating leases as defined in terms of GRAP13: *Leases* or to quantify the possible impact of the straight lining of leases as required by GRAP13. There were no alternative procedures I could perform in order to obtain the audit evidence I required.

Borrowings

13. Included in the statement of financial position at 30 June 2009 is the current portion of non-current borrowings amounting to R1 996 828. This current portion is understated by R2 871 332 and non-current liabilities are overstated by this amount.
14. Interest on borrowings amounting to R1 285 395 was not accrued in the financial statements for the year ended 30 June 2009. Accordingly, borrowings and interest expense are understated by this amount.

Conditional grants and receipts

15. I was unable to obtain documentation to support deferred income amounting to R24 810 323 as included in note 13 to the financial statements and unspent conditional grants and receipts amounting to R3 937 864 as presented in the statement of financial position. Accordingly I was unable to perform the necessary tests or any alternative audit procedures to obtain sufficient appropriate audit evidence to confirm the existence and valuation of deferred income and unspent conditional grants.

Payables from exchange transactions

16. Payables from exchange transactions amounting to R107 958 385 (2008: R35 299 987) are presented in the statement of financial position and disclosed in note 16 to the financial statements. I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of these payables and related expenditure as a result of the following:
- a) I was unable to obtain sufficient appropriate audit evidence for creditors included in the balance for payables from exchange transactions amounting to R3 009 286 (2008: R3 453 745).
 - b) I was unable to obtain sufficient appropriate audit evidence to support accruals amounting to R6 259 909.
 - c) Included in the payables from exchange transactions balance are sundry creditors amounting to R28 382 422. Of this total, I was unable to obtain sufficient appropriate audit evidence to support individual creditors amounting to R2 870 441.
 - d) Suspense accounts included in payables from exchange transactions amounting to R17 175 654 (2008: R4 304 809) were not cleared at year-end by management as required by section 65(2)(j) of the MFMA. I was unable to obtain evidence to support the transactions included in the suspense accounts.

There were no alternative procedures I could perform in order to obtain the audit evidence I required.

17. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatements were identified:
- a) Creditors with debit balances amounting to R27 405 118 were incorrectly classified as payables from exchange transactions in the financial statements for the year ended 30 June 2009. Accordingly, payables from exchange transactions and other consumer receivables are understated by this amount.
 - b) Capital expenditure amounting to R4 538 160 is incorrectly classified as part of payables from exchange transactions, and not as current year additions to property, plant and equipment. This classification error resulted in payables from exchange transactions and property, plant and equipment being understated by this amount.
 - c) Bulk purchase expenses during the year amounting to R1 217 354 were not accrued in the financial statements for the year ended 30 June 2009. Accordingly, payables from exchange transactions and bulk purchase expenses are understated by this amount.

Value-added tax

18. VAT receivable amounting to R50 660 558 was included in other service receivables as presented in the statement of financial position and note 6 to the financial statements. VAT payable amounting to R704 056 was disclosed in the statement of financial position and VAT payable amounting to R27 393 782 was included in payables from exchange transactions in the statement of financial position and in other payables in note 16 to the financial statements. I was unable to obtain sufficient

appropriate audit evidence to confirm the existence, completeness and valuation of the VAT receivable and payable as a result of the following:

- (a) I was unable to obtain sufficient appropriate audit evidence that an amount of R11 139 988 pertaining to VAT reimbursed by SARS during the current year was appropriately recorded in the accounting records of the municipality.
- (b) In addition to the VAT payable recognised in other payables in note 16 to the financial statements, additional VAT payable amounting to R3 348 219 (2008: R683 095) has been included in other payables of R43 966 252, which forms part of payables from exchange transactions (2008: VAT receivable of R1 781 395 as disclosed in note 7 to the financial statements). I was unable to obtain audit evidence to determine whether this amount payable was in respect of VAT.

There were no alternative procedures I could perform in order to obtain the audit evidence I required.

19. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatement was identified:

- (a) VAT receivable and VAT payable are separately disclosed. In accordance with IAS32: *Financial Instruments: Presentation* management should have offset these balances in the financial statements. Had the balances been correctly classified, VAT receivable would have totalled R22 562 719 at 30 June 2009.
- (b) My report was modified in the prior year in respect of input VAT amounting to R3 800 944 which was not accounted for during the write-off of bad debts during the previous financial year. Accordingly, the VAT receivable balance at 30 June 2008 was understated by this amount.

Defined benefit plan obligation

20. No defined benefit plan obligation has been recognised or disclosed in the financial statements. I was unable to obtain the post-retirement medical and pension fund contracts and the actuarial valuations with respect to the post-retirement medical and pension obligations. There were no alternative audit procedures I could perform to obtain sufficient appropriate audit evidence to confirm the completeness and presentation of the defined benefit plan obligations.

Contingent liabilities

21. I was unable to obtain sufficient appropriate audit evidence to support contingent liabilities to the value of R2 194 080 (2008: I was unable to obtain sufficient appropriate audit evidence to support R1 688 144 of the prior year balance amounting to R3 117 128) as disclosed in note 39 to the financial statements or whether any of these contingent liabilities should be recognised as provisions. I was also unable to determine whether any further contingent liabilities should be disclosed. There were no alternative audit procedures I could perform to obtain sufficient appropriate audit evidence to confirm the completeness, valuation and existence of the contingent liabilities as disclosed in the financial statements.

Capital commitments

22. I was unable to obtain sufficient appropriate audit evidence to support capital commitments amounting to R274 506 303 (2008: R139 331 181) as disclosed in note 37 to the financial statements. There were no alternative audit procedures I could perform to obtain sufficient appropriate audit evidence to confirm the existence, valuation and completeness of the capital commitments.

Revenue

23. Revenue amounting to R253 029 706 (2008: R227 628 730) is presented in the statement of financial performance. Of this amount, I was unable to obtain sufficient appropriate audit evidence confirm that the occurrence, completeness and accuracy of revenue amounting to R132 409 514 and any related consumer debtors as a result of the following:

- (a) A total of 927 meters (2008: 1 123 meters) measuring water and electricity consumption in the municipal area have not been read for more than six months. Furthermore, instances were noted where the accounting system has not recorded any interim averages on which to base estimated consumption of water and electricity. Management was unable to reconcile revenue per the water and electricity revenue reports with amounts recognised in the accounting records. Management was also unable to explain variances between the units of water and electricity sold and the units purchased according to statements from Department of Water Affairs and Forestry (DWAF), Rand Water and Eskom. As a result, I was unable to obtain audit evidence to determine whether water and electricity revenue amounting to R86 473 998 (2008: R104 761 215) is materially misstated.
- (b) The municipality recognised revenue from prepaid electricity amounting to R22 085 515 in full on the date of sale and not when the electricity was used by the consumer as required by GRAP9: *Revenue from Exchange Transactions* (GRAP9). Management did not provide me with an estimate of the electricity revenue that was recognised in instances where the electricity has not yet been used. Therefore, I was unable to determine whether revenue from prepaid electricity is materially overstated and payments received in advance are materially understated.
- (c) Property rates revenue amounting to R33 412 364 is recognised in the statement of financial performance. A total of 6 616 properties on the valuation roll used to calculate property rates have no values attached to them and I was unable to determine the extent of any understatement of property rates revenue. In addition, my recalculation of property rates revenue based on properties with values attached to them on the valuation roll revealed an overstatement of recognised revenue of R4 509 875. Management was unable to reconcile or provide me with an explanation for this overstatement. Accordingly, I was unable to determine whether property rates revenue is materially misstated.
- (d) I was unable to obtain sufficient appropriate audit evidence to support interest earned on long outstanding consumer debtors amounting to R10 438 047.
- (e) I was unable to obtain sufficient appropriate audit evidence to support government grants and subsidies amounting to R2 085 105 recognised in the statement of financial performance.

There were no alternative procedures I could perform in order to obtain the audit evidence I required.

24. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatements were identified:
- (a) Prepaid electricity income of R3 050 452 (2008: R1 188 841) is incorrectly classified as other income in the statement of financial performance. This classification error resulted in other income being overstated and revenue from service charges being understated by this amount.
 - (b) Contrary to the requirements under GRAP9, service charges revenue incorrectly includes inter-departmental charges amounting to R5 585 314 (2008: R2 623 359). Consequently, service charges revenue and general expenses as recognised in the statement of financial performance are overstated by this amount.
 - (c) Additions to property, plant and equipment in the previous year amounting to R4 339 003 were incorrectly recorded in the current year. Consequently, government grants and subsidies in the statement of financial performance and deferred income in the statement of financial position are overstated by R163 948 and R4 175 055, respectively, and current year asset additions are overstated by R4 339 003, as described in paragraph 6(b).

Donated property, plant and equipment

25. Donated property, plant and equipment income from Fezile Dabi District Municipality amounting to R46 806 979 is recognised in the statement of financial performance.

Government grants and subsidies amounting to R3 752 543 have been incorrectly classified as donated property, plant and equipment. Accordingly, government grants and subsidies have been understated and donated property, plant and equipment have been overstated by this amount.

Depreciation and amortisation

26. Depreciation and amortisation amounting to R2 811 936 are recognised in the statement of financial performance and disclosed in note 1 to the financial statements. As a result of the matters described in paragraph 5 above, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, occurrence and accuracy of depreciation and the valuation of accumulated depreciation amounting to R2 811 936. There were no alternative procedures I could perform in order to obtain the audit evidence I required.
27. In addition, during the year ended 30 June 2009 the municipality partially implemented GRAP17: *Property, Plant and Equipment*. Accordingly, management calculated depreciation only on the additions during the year ended 30 June 2009. However, the calculation did not take into account the residual values of the assets as required by GRAP17 paragraph 61, resulting in an overstatement of depreciation and an understatement of property, plant and equipment.

General expenses

28. General expenses amounting to R84 102 945 (2008: R111 376 861) have been recognised in the statement of financial performance. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenses as a result of the matters described in paragraph 16 above. In particular, I was unable to obtain sufficient appropriate audit evidence to support general expenses amounting to R4 524 911 (2008: R5 116 251). There were no alternative procedures I could perform in order to obtain the audit evidence I required.
29. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatements were identified:
- (a) I identified expenses amounting to R394 315 that relate to the previous financial year which were incorrectly recorded as current year expenditure. As a result general expenses are overstated by this amount.
 - (b) General expenses recognised in the statement of financial performance incorrectly include payroll related expenses amounting to R2 473 022. This classification error resulted in general expenses being overstated and employee- related costs being understated by this amount.

Repairs and maintenance expenses

30. Repairs and maintenance expenses amounting to R10 108 558 (2008: R9 876 667) have been recognised in the statement of financial performance. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of repairs and maintenance expenses as a result of the matters described in paragraph 16 above. In particular, I was unable to obtain sufficient appropriate audit evidence to support repairs and maintenance expenses amounting to R2 006 938 (2008: R1 827 301). There were no alternative procedures I could perform in order to obtain the audit evidence I required.
31. In addition to the inability to obtain sufficient appropriate audit evidence I have identified expenses amounting to R149 684 relating to the previous financial year which were incorrectly recorded in the statement of financial performance for the year ended 30 June 2009. As a result the repairs and maintenance expenses are overstated by the said amount.

Bulk purchases expenses

32. Bulk purchase expenses amounting to R45 681 554 have been recognised in the statement of financial performance. I was unable to obtain sufficient appropriate audit evidence to confirm occurrence and accuracy of bulk purchase expenses as a result of the matters described in paragraph 16 above. In particular, I was unable to obtain sufficient appropriate audit evidence to support bulk purchase expenses amounting to R7 134 578. There were no alternative procedures I could perform in order to obtain the audit evidence I required.
33. In addition to the inability to obtain sufficient appropriate audit evidence I identified expenses amounting to R2 113 954 relating to the previous financial year which were

incorrectly recorded in the statement of financial performance for the year ended 30 June 2009. As a result bulk purchase expenses are overstated by this amount.

Contribution to indigent debtors

34. Included in "other" general expenses in note 32 to the financial statements are contributions to indigent debtors amounting to R17 726 646 and an impairment provision for consumer debtors amounting to R10 229 796.
- (a) GRAP1: *Presentation of Financial Statements* (GRAP1) paragraph 36 requires items of dissimilar nature or function to be presented separately in the financial statements or in the notes to the financial statements unless they are immaterial. Because of their nature and significance, contributions to indigent debtors should be presented as a separate category in note 32 to the financial statements.
- (b) In addition, because of its nature and significance the impairment provision for consumer debtors should be included in bad debts in the statement of financial performance.

Non-compliance with the GRAP reporting framework

35. Material errors, omissions and inconsistencies relating to classifications and disclosures in the financial statements are summarised below:
- (a) The financial statements contain various casting errors and internal inconsistencies.
- (b) Contrary to the requirements under GRAP1, the classification of the comparative disclosures does not conform to the current year classifications and the financial statements do not include comparative disclosures for a number of current year disclosures included in the financial statements. GRAP1 also requires disclosure of the nature and amount of and the reason for any reclassification of comparative disclosures. While the comparative information in the financial statements for the year ended 30 June 2009 includes significant reclassifications from the prior year issued financial statements, the required disclosures were not included in the financial statements.
- (c) GRAP3: *Accounting Policies, Changes in Accounting Estimates and Errors* requires the municipality to retrospectively adjust the comparative disclosures with the correction of prior year errors and to include appropriate disclosure in this regard in the financial statements. Journal entries amounting to R20 083 938 (2008: R4 269 045) in respect of prior year errors were processed against accumulated surplus in the current year. These corrections of prior year errors were not made retrospectively nor did the financial statements include appropriate disclosures in this regard. I was unable to obtain sufficient appropriate audit evidence to confirm the accuracy and occurrence of these journal entries. There were no alternative audit procedures I could perform in order to obtain the audit evidence I required.
- (d) In contravention of the disclosure requirements of IFRS7: *Financial Instruments: Disclosures* several qualitative disclosures relating to the municipality's financial instruments were not included in the financial statements.

- (e) Accounting Standards Board, Directive 4 paragraph 8A requires the municipality to disclose details regarding the application of transitional provisions, the nature and amount of measurement adjustments and information on the progress made towards full GRAP compliance. During the current financial year the municipality adopted the GRAP reporting framework. The disclosures required under Directive 4 were not incorporated in the financial statements for the year ended 30 June 2009.

Unauthorised, fruitless and wasteful and irregular expenditure

36. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence and accuracy of fruitless and wasteful expenditure amounting to R1 795 902 as disclosed in note 44 to the financial statements. There were no alternative procedures I could perform in order to obtain the audit evidence I required.
37. The municipality incurred funeral and credit card expenses during the year. Management was unable to provide me with a list of funeral expenses and credit card statements. In addition, I was unable to confirm where these expenses were recorded in the accounting records of the municipality. Accordingly, I was unable to obtain sufficient appropriate audit evidence to confirm whether fruitless and wasteful expenditure occurred.
38. Procurement documentation for additions to property, plant and equipment amounting to R22 591 377 could not be provided and the possible occurrence of irregular expenditure due to non-compliance with the supply chain management policy and Preferential Procurement Policy Framework Act, 2000 (Act No 5 of 2000) could therefore not be evaluated.
39. In addition to the inability to obtain sufficient appropriate audit evidence, the following misstatements were identified:
- (a) The municipality did not disclose in the financial statements the following fruitless and wasteful expenditure totalling R145 056 (2008: R1 639 409), as required by section 125(2)(d) of the MFMA:
- i. The municipality incurred fruitless and wasteful expenditure as a result of duplicate annual bonus payments amounting to R3 363, excessive overtime payments amounting to R1 927 and duplicate payments to employees amounting to R32 105.
 - ii. Additional interest charged amounting to R100 220 with respect to the late payment of instalments on long term liabilities.
 - iii. Payment of damages amounting to R7 441 to a member of the public due to negligence on the part of the municipality.
- (b) Irregular expenditure amounting to R1 391 254 in respect of the misuse of municipal garage cards was incorrectly disclosed as fruitless and wasteful expenditure. In addition, irregular expenditure incurred due to the misuse of municipal garage cards and non-compliance with the supply chain management policy amounting to R2 412 464 (2008: R4 082 055) was not disclosed in the financial statements.
- (c) Contrary to sections 1, 15 and 32 of the MFMA it was noted that expenditure exceeded the budget on certain votes amounting to R22 429 579 (2008:

R48 247 152). This unauthorised expenditure was not disclosed in the financial statements as required by the MFMA.

Going concern

40. As a result of the matters described in the basis for disclaimer of opinion paragraph, the municipality may be in a worse financial position than the position reflected in these financial statements. The difficulties being experienced by the municipality in recovering debts as well as the potential negative effect of this tendency on the cash flows of the municipality, indicate that there is a risk that the municipality may be exposed to serious financial difficulties, which may require provincial or national intervention arising from financial crisis as set out in terms of sections 139 and 150 of the MFMA.

Disclaimer of opinion

41. 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.

OTHER MATTERS

Unaudited supplementary schedules

42. The supplementary information set out on pages [X] to [x] 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

43. Municipal Systems Act, 2000 (Act No. 32 of 2000 (MSA))

(a) Management could not provide me with sufficient appropriate audit evidence to verify compliance with the following sections of the MSA:

- i. Section 28: Public participation in the integrated development plan.
- ii. Regulation 15(3): Public participation in the integrated development plan.
- iii. Section 25(4): Notice to the public regarding the integrated development plan.
- iv. Section 32(1)(a): Copy of the Integrated development plan submitted to MEC.
- v. Section 34(a)(i): Performance evaluation.
- vi. Section 15: Municipal code.

(b) Contrary to the requirements of section 55(2)(c) of the MSA, which states that the municipal manager should ensure proper and diligent compliance with the MFMA, I identified various instances of non-compliance with the MFMA.

- (c) Contrary to the requirements of section 11 of the MSA there is no documented and approved policy in place which relates to the following areas:
 - i. Irregular, unauthorised and fruitless and wasteful expenditure
 - ii. Capital replacement reserve and other reserves
 - iii. Disclosure of capital commitments
 - iv. Manual journals
 - v. Process for identifying, evaluating, managing and disclosure of litigation and claims against the municipality.
44. Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA)
- (a) Management could not provide me with sufficient appropriate audit evidence to verify compliance with the following sections of the MFMA:
 - i. Section 32(4): Reports on unauthorised, irregular and fruitless and wasteful expenditure that should have been submitted.
 - ii. Section 53(1)(c)(ii): Service delivery and budget implementation plan.
 - iii. Section 72(1): Performance assessment.
 - iv. Section 44: Resolution of a dispute with Department of Water Affairs and Forestry (DWAF).
 - (b) Contrary to the requirements of section 74(1) of the MFMA management could not provide me with sufficient appropriate audit evidence for various accounts included in the basis of disclaimer paragraph.
 - (c) Contrary to section 62(1)(c)(i) of the MFMA, the system of internal controls does not provide adequate assurance that assets are safeguarded and that transactions are executed and recorded in accordance with the municipality's policies and procedures.
 - (d) Contrary to the requirements of section 65(2)(j) of the MFMA there were various suspense accounts that had not been cleared at year-end.
 - (e) Contrary to the requirements of section 52(d) of the MFMA certain quarterly reports had not been submitted within the specified time-frame.
 - (f) Contrary to the requirements of section 69(3) of the MFMA the accounting officer failed to submit drafts of the annual performance agreements and the service delivery and budget implementation plan for the budget year to the mayor within 14 days after the approval of the annual budget.
 - (g) Contrary to the requirements of section 67(1)(d) of the MFMA a system to monitor, measure and evaluate the performance of personnel other than management had not yet been developed and implemented.
 - (h) Contrary to the requirements of section 17 of the MFMA the budget for the current financial year (2008-09) did not contain the details required by section 17(3)(b) and 17(3)(i) of the MFMA.
 - (i) Contrary to the requirements of section 45(4)(a) of the MFMA the municipality did not repay all short-term debt by the end of the current financial year.

- (j) Contrary to the requirements of Section 54(1)(c) of the MFMA the mayor did not consider the revision of the service delivery and budget implementation plan on the receipt of the monthly budget statements.
- (k) Contrary to the requirements of section 60 and 62 of the MFMA I identified various instances of unauthorised, irregular and fruitless & wasteful expenditure. No policy exists for this expenditure. I also identified instances where proper records of the financial affairs are not kept by the municipality.
- (l) Contrary to the requirements of section 73 of the MFMA I could not obtain any evidence that the municipality had informed the provincial treasury of its non-compliance with the supply chain management policy.
- (m) Contrary to the requirements of section 123(1) of the MFMA, information on how allocations received have been spent, whether the conditions of allocations received had been met by the municipality and the reasons for non-compliance with conditions of allocations received had not been disclosed in the financial statements.
- (n) Contrary to the requirements of section 127 of the MFMA, the annual report for the year ended 30 June 2008 had not been issued within seven months after the end of the previous financial year.
- (o) Contrary to the requirements of section 121(3) of the MFMA, the 2007-08 annual report did not include various details required by the act such as the Auditor General's report on the financial statements.
- (p) Contrary to the requirements of section 125 of the MFMA, various instances were identified where non-compliance with the MFMA had not been disclosed in the financial statements.
- (q) Contrary to the requirements of section 65(2)(e) of the MFMA, creditor payments were made after the required 30-day period.
- (r) Contrary to the requirements of section 131 of the MFMA, various issues raised by the Auditor- General in the prior year audit report had not been adequately addressed.
- (s) Contrary to the requirements of section 129 of the MFMA, the municipality did not issue the required oversight report.

Governance framework

45. The governance principles that impact the auditor's opinion on the financial statements relate 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

46. 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
6 & 7	Property, plant and equipment			3	1	1
8 & 9	Accounts receivable	7		3	1	
10 & 11	Cash and cash equivalents			5	1	
13	Finance lease liabilities and operating leases				1	
14 & 15	Borrowings			5	1	
16	Conditional grants and receipts				1	
17 & 18	Payables from exchange transactions	7		3;5	1	
19 & 20	Value-added tax			5	1	
21	Defined benefit plan obligation				1	
22	Contingent liabilities				1	
23	Capital commitments			5		
24 & 25	Revenue	7		4;5	1	
26	Donated property, plant and equipment				1	
27 & 28	Depreciation and amortisation				1	
29 & 30	General expenses	7		3	1	
31 & 32	Repairs and maintenance expenses			3	1	
33 & 34	Bulk purchases expenses			3	1	
35	Contribution to indigent debtors	7				
36	Non-compliance with the GRAP reporting framework	7				
37 – 40	Unauthorised, fruitless and wasteful and irregular expenditure			3; 4; 5	1	1

Overall reflections on the governance framework based on internal control deficiencies

- (a) Deficiencies in the filing system and a lack of controls over the administration of supporting documentation resulted in delays in supplying documentation as well as the unavailability of documentation. This key governance deficiency is attributed to a shortage of skilled and committed staff members within the municipality.
- (b) Capacity and resource constraints due to cash flow difficulties resulted in the lack of a fixed asset register.
- (c) Significant accounts are not reconciled timeously and sufficient action is not taken to clear suspense accounts.

- (d) Financial officials lack knowledge regarding the requirements of the GRAP reporting framework.
- (e) The lack of risk assessment processes resulted in insufficient control measures being implemented by the chief financial officer.
- (f) The lack of policies and procedures implemented to guide the effective oversight, monitoring and review of the financial statements resulted in the financial statements being subject to a large number of errors and significant non-compliance with the disclosure requirements of the GRAP reporting framework.
- (g) The municipality does not have adequate systems in place to appropriately record prepaid electricity revenue in accordance with GRAP9.

Legend	
CE = Control environment	
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
RA = Risk assessment	
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
CA = Control activities	
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 in turn are not linked to an effective reward system.	7
IC = Information and communication	
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
M = Monitoring	
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

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

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	X	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		X
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		

No.	Matter	Y	N
	<ul style="list-style-type: none"> The municipality had an audit committee in operation throughout the financial year. 		X
	<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. 		X
	<ul style="list-style-type: none"> The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 		X
7.	Internal audit		
	<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. 	X	
	<ul style="list-style-type: none"> The internal audit function operates in terms of an approved internal audit plan. 		X
	<ul style="list-style-type: none"> 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)/95(c)(i) of the MFMA.		X
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.		X
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented.		X
Issues relating to the reporting of performance information			
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 municipality against its mandate, predetermined objectives, outputs, indicators and targets in accordance with section 68/87 of the MFMA.	X	
18.	There is a functioning performance management system.		X

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

- (a) Deficiencies in the filing system and a lack of controls over the administration of supporting documentation resulted in delays in supplying documentation as well as the unavailability of documentation.
- (b) The lack of implemented policies and procedures to guide the effective oversight, monitoring and review of the financial statements impacted on the quality of the financial statements.
- (c) Unavailability of key officials during the audit due to operational responsibilities as well as a lack of resources due to cash flow difficulties.
- (d) Resource constraints due to cash flow difficulties resulted in a lack of prioritising the implementation of governance structures.
- (e) Resource constraints due to cash flow difficulties resulted in a lack of prioritising risk management and internal control design and implementation.
- (f) The lack of implemented policies and procedures relating to compliance with laws and regulations resulted in various instances of non-compliance with enabling legislation.
- (g) Resource constraints due to cash flow difficulties resulted in a lack of a sub delegation process.
- (h) Resource constraints due to cash flow difficulties resulted in a lack of prioritising the follow-up and correction of significant audit findings.
- (i) Resource constraints imposed by cash flow difficulties resulted in lack of an effective performance management system.

Investigations

48. The municipality is conducting an investigation into the misuse of garage cards by employees. The investigation was initiated based on allegations of fraudulent use of municipal garage cards for personal gain. The investigation has resulted in a case being opened with the South African Police Services.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

49. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for performance information

50. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include an 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 to confirm 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 review findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

54. Due to the lack of implemented policies and procedures relating to the compliance with laws and regulations there was overall non-compliance by the municipality with the legislative requirements pertaining to the planning, monitoring, managing and reporting of performance information as evidenced by the findings listed below.
 - (a) The municipality does not have a functional performance management system as required by section 38(a) of the MSA.
 - (b) Contrary to the requirements of section 41(1)(d) and regulation 13(2)(b) and (c) of the MSA, there was an overall lack of effective mechanisms, systems and processes to monitor performance management and reporting.
 - (c) The integrated development plan did not include details such as adequate key performance indicators, performance targets and a financial plan with a budget projection for the next three years as required in terms of section 26 of the MSA.
 - (d) Evidence could not be obtained regarding proper public participation in the compilation and adoption of the integrated development plan as required by section 25 and 28 and regulation 15(3) of the MSA.
 - (e) Due to the lack of information received, I could not conclude on whether the municipal manager had submitted a copy of the integrated development plan to the MEC of local government in the province as required by section 32(1)(a) of the MSA.
 - (f) Key performance indicators included in the integrated development plan and strategic plan do not comply with the requirements of section 41(1)(a) and (b) of the MSA which also resulted in non-compliance with section 42 and 43 of the MSA as well as certain regulations linked to these sections.
 - (g) Contrary to the requirements of section 41(1)(b) and regulation 12(1) and 12(2)(e) of the MSA I found that the integrated development plan does not include performance targets clearly linked to development priorities, while many performance targets listed are not measurable.
 - (h) Contrary to the requirements of regulation 6(a) of the MSA, the annual budget is not aligned with the integrated development plan.

- (i) Contrary to the requirements of section 43 of the MSA the general performance indicators are not included in the municipality's strategic plan.
- (j) Contrary to the requirements of section 34(b) of the MSA, no evidence could be obtained that the amended key performance indicators in the performance report had been approved by council.
- (k) Contrary to the requirements of section 46(1)(a) of the MSA the municipality's performance report did not reflect the performance of any of its external service providers.

Inconsistently reported performance information

- 55. The strategic objectives in the strategic plan and the integrated development plan are not aligned due to a lack of management oversight and monitoring of performance information.

Reported performance information not reliable

- 56. Sufficient appropriate audit evidence in relation to the reported performance information relating to water and electricity could not be obtained, as the relevant source documentation could not be provided for audit purposes. This resulted from deficiencies in the filing system, a lack of controls over the administration of supporting documentation as well as a shortage of skilled and committed staff members within the municipality.

Performance information not received in time

- 57. Performance information was not received within the agreed time frame due to the lack of prioritising the reporting of performance information, the lack of management oversight as well as the lack of an effective performance management system.
- 58. An assessment could not be performed on whether the municipality complies with section 53(1)(c)(ii) of the MFMA since the information was not received in time for audit purposes.

APPRECIATION

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

Auditor-General
Bloemfontein

30 November 2009



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence