

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

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 2010 and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, 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 the South African Standards of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). 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) and 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. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation of and rights to property, plant and equipment with a carrying value of R580 878 678 (2009: R553 366 069), as disclosed in the statement of financial position and note 2 to the financial statements. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness and valuation of and rights to property, plant and equipment.

- (a) The municipality did not maintain an accurate fixed asset register as required by section 63(2)(c) of the MFMA. The net carrying value of R580 878 678, as disclosed in note 2 to the financial statements, did not agree to the balance of R525 809 312, as per the fixed assets register. No explanations could be obtained for the unreconciled difference of R55 069 366. Consequently, I was unable to confirm the existence, completeness, valuation of and rights to property, plant and equipment. I could also not confirm:
- The accuracy and completeness of additions of R58 380 597 as disclosed in note 2 to the financial statements.
 - That all disposals of property, plant and equipment had been accounted for in the accounting and underlying records.
 - The accuracy of accumulated depreciation which amounted to R33 679 924 at 30 June 2010.
 - The existence, accuracy and completeness of depreciation and amortisation of assets, amounting to R30 867 988 (2009: R2 811 936), as disclosed in note 2 to the financial statements.
- (b) Contrary to the requirements of paragraph 5 of the SA Standard of GRAP, GRAP 16 *Investment Property* (GRAP 16), the municipality did not perform an evaluation in terms of GRAP 16 to determine which properties should be disclosed as investment properties.
- (c) 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 compliance with the SA Standards of GRAP. During the prior financial year the municipality adopted the GRAP reporting framework. The disclosures required under Directive 4 for property, plant and equipment were not incorporated into the financial statements for the year ended 30 June 2010.
- (d) My report was modified in the previous year as a fixed asset register was not provided. Accordingly, I was unable to obtain sufficient appropriate audit evidence that property, plant and equipment with a carrying value of R580 878 678 and the corresponding disclosure of R553 366 069, as disclosed in the statement of financial position and note 2 to the financial statements, did not contain significant misstatements.
5. My report was modified in the prior year in respect of the following misstatements. Sufficient and appropriate audit evidence could not be obtained that these misstatements had been followed up and resolved. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness and valuation of and rights to the corresponding amount to property, plant and equipment of R553 366 069 at 30 June 2009, as disclosed in the statement of financial position and note 2 to the financial statements.
- (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 additions and donated property, plant and equipment income.
- (b) Property, plant and equipment was understated by R1 746 837, as value-added tax (VAT) of R742 267 was claimed on invalid VAT invoices in terms of section 20 of the VAT Act of South Africa, 1991 (Act No. 89 of 1991) and assets received from Fezile Dabi District Municipality were understated by R1 004 570.
- (c) Additions of R1 620 175 were duplicated.

Trade and other receivables

6. Consumer debtors from exchange transactions, before any impairment adjustments, amounted to R216 806 855 (2009: R149 945 323) as disclosed in note 7 to the financial statements. Management raised a general provision of R177 620 363 (2009: R45 275 422) for impairment against these consumer debtors. In view of the following, I could not confirm the completeness, existence and accuracy of consumer debtors with a carrying value of R39 186 493 (2009: R104 669 903). The municipality's records did not permit the application of alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the completeness, existence and accuracy of consumer debtors.
- (a) A detailed list of debtors or balances which substantiate the carrying value of R39 186 493 could not be obtained;
 - (b) The consumer debtors balance of R216 806 855, as disclosed in note 7 to the financial statements, did not agree to the age analysis, resulting in an unexplained difference of R5 332 568. Sufficient appropriate audit evidence could not be obtained for this difference. Due to the lack of audit evidence I could not determine the effect on the other account balances or classes of transactions reported in the financial statements.
 - (c) Management could not provide me with sufficient appropriate audit evidence to confirm that indigent debtors registered had been approved and that they complied with the minimum requirements set to qualify for the monthly subsidies. The occurrence of indigent subsidies of R14 096 417, as disclosed in note 19 to the financial statements, could therefore not be confirmed.
 - (d) With reference to paragraph 27, I could not obtain all the information and explanations we considered necessary for the verification of revenue. These issues could affect the carrying value of consumer debtors as at 30 June 2010.
 - (e) Management could not, within the required time frame, provide me with a detailed list of the journals processed on the billing system. These journals would impact the reported revenue, debtors and VAT balances. I was unable to test the completeness, accuracy and validity of the journals processed against consumer debtors.
 - (f) Consumer debtors with a carrying value of R104 669 903 as at 30 June 2009 could not be confirmed. Accordingly, I was unable to obtain sufficient appropriate audit evidence that consumer debtors with a carrying value of R216 806 855 and the corresponding disclosure of R149 945 323 in note 7 to the financial statements did not contain significant misstatements.
 - (g) Contrary to the minimum disclosure requirements of paragraph 79 of the SA Statement of GRAP, GRAP 1, *Presentation of Financial Statements* (GRAP 1), as well as the classification of property rates revenue as non-exchange revenue in the accounting policies, we found that the consumer debtors balance presented in the statement of financial position and disclosed in note 7 to the financial statements, amounting to R39 186 493, included property rate debtors amounting to R7 438 043. Therefore, consumer receivables from non-exchange transactions is understated by R7 438 043 and consumer receivables from exchange transactions is overstated by R7 438 043.
 - (h) Contrary to the minimum disclosure requirements of paragraphs 132, 135 and 137 of GRAP 1, the municipality did not disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, which holds a significant risk of requiring a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The significant movement in the doubtful debts provision would warrant such a disclosure.

- (i) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reason for the reclassification of corresponding figures, was not included in the financial statements. The corresponding amount for consumer debtors was adjusted from R158 474 398 to R104 669 903 in the 30 June 2010 financial statements. Management could not provide me with sufficient appropriate audit evidence to enable me to audit these restatements of comparative information. Consequently, I could not perform alternative procedures to obtain sufficient appropriate audit evidence as to the completeness, existence and accuracy of these restatements.
 - (j) I was unable to obtain sufficient appropriate audit evidence for debit journals of R18 146 318 and credit journals of R140 119 669. I was unable to test the completeness, accuracy and validity of the journals processed against trade and other receivables.
7. My report was modified in the prior year in respect of uncorrected overcharges of R2 347 272 in respect of water and electricity. Management could not provide me with sufficient appropriate audit evidence that these misstatements had been followed-up and resolved. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to confirm the existence, completeness, valuation of and rights to consumer debtors of R216 806 855 and the corresponding disclosure of R149 945 323 as disclosed in note 7 to the financial statements.
8. Suspense accounts with debit balances of R32 449 930 included in the disclosure of trade and other receivables in the statement of financial position and note 6 to the financial statements had not been cleared at year-end, as required by section 65(2)(j) of the MFMA. I was unable to obtain sufficient appropriate evidence to support the transactions and balances included in these suspense accounts. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not confirm the existence, completeness and valuation of trade and other receivables from exchange transactions of R32 449 930 (2009: R27 635 060).

Trade and other payables

9. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of payables from exchange transactions, of R73 365 629 (2009: R105 060 786), as disclosed in the statement of financial position. The municipality's records did not permit the application of alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to confirm the existence, completeness, valuation of trade and other payables.
- (a) Trade and other payables amounting to R17 166 269 did not agree to the detailed creditors list totalling R13 474 550. The entity did not reconcile the difference of R3 691 719 between the financial statements and the underlying accounting records. Consequently, the trade payables balance is misstated by R3 691 719. I could not determine the effect thereof on the other account balances or classes of transactions contained in the financial statements.
 - (b) Suspense accounts with credit balances of R36 576 019 were included in trade and other payables. These suspense accounts were not cleared at year-end, as required by section 65(2)(j) of the MFMA. I was unable to obtain sufficient appropriate evidence to support the transactions and balances included in these suspense accounts.
 - (c) The leave pay provision of R6 488 373 was included in payables from exchange transactions. An unexplained difference of R1 422 739 was identified between the detailed calculation and the amount included in the municipality's financial statements. Furthermore, management could not provide me with an accurate leave pay calculation.

- (d) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reasons for the reclassification of corresponding figures were not included in the financial statements. The corresponding amount for trade and other payables was adjusted from R107 958 385 to R105 060 786 in the 30 June 2010 financial statements. Management could not provide me with sufficient appropriate audit evidence to enable me to audit these restatements of the comparative information.
 - (e) I was unable to obtain sufficient appropriate audit evidence for debit journals of R184 391 344 and credit journals of R122 766 345. I was unable to test the completeness, accuracy and validity of the journals processed against trade and other creditors.
10. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:
- (a) The municipality did not accrue for invoices in respect of goods and services received before year-end amounting to R38 383 228, due to transactions being recorded without being reviewed and authorised. If these invoices had been accrued, bulk purchases expenditure would have increased, the accumulated surpluses decreased and the accrued liability increased by R38 383 228.
 - (b) Bulk purchase expenses amounting to R71 163 816 were not accrued. R27 240 440 relates to the current year, while R43 923 376 relates to prior years. Accordingly, payables from exchange transactions were understated by R27 240 440, current year bulk purchase expenses were understated by R27 377 303 and the accumulated surplus opening balance at 30 June 2009 was overstated by R43 923 376.

Unspent conditional grants and receipts

- 11. Included in unspent conditional grants disclosed in note 11 to the financial statements is an amount of R4 798 612 which was received from Public Works for services rendered by the municipality. The amount should have been recognised as revenue. Had the services rendered been recorded as revenue, revenue would have increased and the deficit for the year and unspent conditional grants would have decreased by R4 798 612.
- 12. My report was modified in the prior year as I was unable to obtain sufficient appropriate audit evidence for unspent conditional grants of R3 937 864 as at 30 June 2009. Accordingly, I was unable to obtain sufficient and appropriate audit evidence that the opening balance of unspent conditional grants and receipts did not contain a significant misstatement. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to confirm the existence, completeness and valuation of and the obligation in respect of unspent conditional grants of R18 174 724 and the corresponding disclosure of R3 937 863, as disclosed in note 11 to the financial statements.

Other financial liabilities

- 13. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Interest on financial liabilities amounting to R3 912 247 (2009: R1 285 395) was not included in the financial statements for the year ended 30 June 2010. Accordingly, other financial liabilities and interest expense were understated and the accumulated surplus overstated by R3 912 247.

Finance lease liabilities and operating leases

14. I was unable to obtain all the lease agreements requested during the audit. 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 of R4 530 401 (2009: R1 326 664), disclosed under various captions in note 19 to the financial statements, and the financial lease liability amounting to R1 148 622 (2009: R1 838 257) as disclosed in the statement of financial position. I was also unable to determine whether the municipality appropriately classified leases as either finance or operating leases, as defined in terms of SA Standard of GRAP, GRAP 13: *Leases* (GRAP 13), or to quantify the possible impact of the straight-lining of leases as required by GRAP 13. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to ensure the completeness of operating lease expenses and the financial lease liability.

Cash and cash equivalents

15. Management could not provide any supporting documentation for the following items included in the municipality's bank reconciliation at 30 June 2010. I could not obtain sufficient supporting documentation and accordingly, I could not determine the effect on the other account balances and classes of transactions reported in the financial statements. The municipality's records did not permit the application of alternative audit procedure and accordingly, I could not obtain sufficient appropriate audit evidence to ensure the existence and completeness of cash and cash equivalents.

(a) Outstanding deposits of R1 550 428.

(b) Unallocated deposits, of R1 103 050.

16. I was unable to obtain sufficient appropriate audit evidence for credit journals of R24 856 088. I was unable to test the completeness, accuracy and validity of the journals processed against cash and cash equivalents.

17. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The municipality reported a bank overdraft of R26 064 617 in the statement of financial position and note 8 to the financial statements. The bank reconciliation includes unreleased electronic fund transfers (EFT) of R25 882 287 and outstanding cheques of R2 471 973 which were only captured after year-end. Consequently, the bank overdraft was overstated by R28 354 260 and trade and other payables from exchange transactions understated by R28 354 260.

Accruals, provisions and contingent liabilities

18. Provision has not been made for the environmental rehabilitation costs of restoring the municipality's landfill sites. A provision should be made for the municipality's present obligation incurred as a consequence of its past use of the landfill sites, in accordance with SA Standards of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets* (GRAP 19). In the absence of a valuation in respect of the costs for the rehabilitation of landfill sites, I was unable to quantify the extent of the understatement of provisions.

19. The municipality has not disclosed or raised a provision in respect of pending litigation and legal actions of R31 793 253 instituted against the municipality. Management has not evaluated these legal actions to determine whether they should be disclosed as contingent liabilities or provided for in accordance with GRAP 19. In the absence of this evaluation and supporting documentation, I was unable to quantify the extent of the understatement of accruals, provisions and contingent liabilities.

20. Contrary to the requirements of paragraph 83(c) of SA Standards of GRAP, GRAP 17, *Property, plant and equipment*, the municipality did not disclose any capital commitments in the notes to the financial statements. Capital commitments of R274 506 303 disclosed in the prior year's financial statements have not been included in the corresponding amounts for commitments in the 30 June 2010 financial statements. In the absence of financial records in respect of capital commitments, I was unable to quantify the extent of the understatement of capital commitments.

Post-retirement medical aid obligation

21. No post-retirement medical aid obligation has been recognised or disclosed in the financial statements. In the absence of post-retirement medical aid contracts and actuarial valuations, I was unable to quantify the extent of the understatement of debtors.

Value-added tax

22. A VAT receivable of R13 598 344 (2009: R22 567 780) was disclosed in the statement of financial position and in note 12 to the financial statements. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of VAT receivable. The municipality's records did not permit the application of alternative audit procedure and accordingly, I could not confirm the existence, completeness and valuation of VAT receivable.

(a) I was unable to obtain sufficient appropriate audit evidence that VAT reimbursements of R8 292 533 (2009: R11 139 988) by the South African Revenue Service (SARS) during the current year were appropriately recorded in the accounting records of the municipality.

(b) Suspense accounts with debit balances of R2 364 716 and credit balances of R29 811 248 have been included in VAT receivable. I was unable to obtain audit evidence to determine whether this amount is in respect of VAT.

(c) Unknown deposits of R21 311 319 have been included in payables from exchange transactions presented in the statement of financial position. The value-added tax (VAT) implications on these unallocated deposits were also uncertain and had not been considered. Due to the lack of information on the unallocated receipts, no alternative procedures could be performed.

(d) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reason for the reclassification of comparative disclosures was not included in the financial statements. The corresponding amount for VAT receivable was adjusted from R0 to R22 567 780 in the 30 June 2010 financial statements.

(e) I was unable to obtain sufficient appropriate audit evidence for debit journals of R952 501 and credit journals of R7 160 348. I was unable to test the completeness, accuracy and validity of the journals processed against VAT accounts.

23. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Input VAT claimed of R2 237 869 was disallowed by SARS. Management has not accounted for the disallowed VAT and accordingly, VAT receivable was overstated by R2 237 869.

24. My report was modified in the prior year in respect of input VAT of R3 800 944 which was not accounted for during the write-off of bad debts during the 2007-08 financial year. Management could not provide me with sufficient appropriate audit evidence to confirm that these misstatements had been followed up and resolved. The municipality's records did not permit the performance of reasonable alternative audit procedures and I was therefore unable to perform all the procedures I considered necessary to obtain adequate audit assurance as to the existence, completeness and valuation of and rights to VAT receivables of R13 598 344 and the corresponding disclosure of R22 567 780 as disclosed in the statement of financial position and in note 12 to the financial statements.

Accumulated surplus

25. Due to the disclaimer of opinion on the prior year's financial statements and the audit matters listed below, I could not obtain sufficient appropriate audit evidence to ensure the existence, completeness and valuation of accumulated surplus. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to ensure that accumulated surplus is fairly stated in the financial statements.
- (a) Sufficient appropriate evidence could not be obtained that prior year misstatements had been corrected, nor had the scope limitations imposed during prior years been resolved. Accordingly, I was unable to obtain sufficient appropriate audit evidence that the accumulated surplus of R529 244 192 and the corresponding disclosure of R578 147 479 as disclosed in the statement of financial position did not contain significant misstatements.
 - (b) An adjustment of R6 884 645 was made against accumulated surplus as disclosed in the statement of change in net assets. Management could not provide any documentation to substantiate this adjustment.
 - (c) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reasons for the reclassification of comparative disclosures was not included in the financial statements. The comparative amount for accumulated surplus was adjusted from R553 337 154 to R578 147 479 in the 30 June 2010 financial statements.
 - (d) I was unable to obtain sufficient appropriate audit evidence for debit journals of R2 489 609 and credit journals of R73 684. I was unable to confirm the completeness, accuracy and validity of the journals processed against the accumulated surplus account.

Deferred income

26. Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reasons for the reclassification of comparative disclosures was not included in the financial statements. The corresponding amount for deferred income was adjusted from R24 810 323 to R0 in the 30 June 2010 financial statements. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to ensure the completeness of deferred income.

Revenue

27. Revenue of R353 566 460 (2009: R319 043 843) is disclosed in the statement of financial performance. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, existence and accuracy of revenue of R167 258 504 (2009: R132 409 514) included in this disclosure. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to confirm the completeness, existence and accuracy of revenue.
- (a) A total of 722 meters (2009: 927 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. Revenue per the water and electricity revenue reports could not be reconciled to the revenue recognised in the accounting records.
 - (b) Management did not make an estimation of the unmetered consumption as at 30 June 2010. Due to the above-mentioned deficiencies, we were unable to quantify the understatement of revenue.

- (c) Reasons for variances between the units of water and electricity sold and the units purchased according to statements from Department of Water Affairs and Forestry, Rand Water and Eskom, could not be determined. Due to the deficiencies relating to the related record, the misstatement cannot be accurately quantified.
 - (d) Water sales of R30 552 623 is included in the statement of financial performance. No valid explanation could be obtained in respect of monthly fluctuations of up to R1 096 247 607 levied when compared to the average water sales recorded.
 - (e) Electricity sales of R37 980 003 are included in the statement of financial performance. No valid explanations could be obtained in respect of monthly fluctuations of up to R26 521 501 levied when compared to the average electricity sales recorded.
 - (f) The municipality recognised revenue from prepaid electricity of R32 620 510 (2009: R22 085 515) in full on the date of sale and not only when the electricity was used by the consumer, as required by SA Standards of GRAP, GRAP 9: *Revenue from Exchange Transactions* (GRAP 9). As a result, the sale of prepaid electricity revenue, has been incorrectly recognised as revenue instead of deferred income, as required by GRAP 9. Due to the volume of transactions involved and the fact that the system could not provide us with the relevant information, I could not quantify the extent by which revenue is overstated and deferred income is understated in the financial statements. No reasonable alternative audit procedure could be performed in this regard.
 - (g) Revenue from property rates of R54 832 745 (2009: R33 412 364) is recognised in note 15 to the financial statements. A total of 165 properties (2009: 6 616) on the valuation roll had no values allocated to them and I was unable to determine the extent of any understatement of property rates revenue. My recalculation of property rates revenue, based on properties with values allocated to them, revealed an understatement of property rate revenue of R6 570 000 (2009: overstatement of R4 509 875), for which no reasonable explanation could be obtained.
 - (h) I was unable to obtain sufficient appropriate audit evidence to support interest earned on long-outstanding consumer debtors amounting to R12 954 888 (2009: R10 438 047). As a result, I was unable to confirm the occurrence and accuracy of these transactions included under revenue in the financial statements.
 - (i) Management could not provide supporting documentation for sundry income amounting to R1 778 501. As a result, I was unable to confirm the occurrence and accuracy of these transactions included under revenue in the financial statements.
 - (j) I was unable to obtain sufficient appropriate audit evidence for debit journals of R5 774 289 and for credit journals of R54 788 744. I was unable to test the completeness, accuracy and validity of the journals processed against revenue.
28. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:
- (a) Rent income of R1 707 561 is incorrectly included under debtors, with credit balances as disclosed under trade and other payables in the statement of financial position. Consequently, rent income is understated and debtors with credit balances are overstated by R1 707 561.
 - (b) Discounts relating to property rates amounting to R18 589 477 included in note 16 to the financial statements have been set off against service charge revenue. Consequently, property rates revenue are overstated and service charges are understated by R18 589 477.

(c) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reason for the reclassification of comparative disclosures was not included in the financial statements. Management could not provide me with sufficient appropriate audit evidence to enable me to audit these restatements of the comparative information. Consequently, I could not perform alternative procedures to obtain sufficient appropriate audit evidence of these restatements. The comparative disclosure for the following captions was adjusted in the 30 June 2010 financial statements:

- Service charges were adjusted from R122 002 627 to R116 399 462; and
- Government grants and subsidies were adjusted from R80 077 377 to R151 694 679.

Repairs and maintenance expenditure

29. Repairs and maintenance expenditure of R15 042 897 (2009: R10 108 558) have been recognised in the statement of financial performance. The municipality could not provide supporting documentation for debit transactions of R241 110 (2009: R2 006 938) and credit entries of R373 369. The municipality's records did not permit the application of alternative audit procedures regarding repairs and maintenance expenditure. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of repairs and maintenance expenditure.

30. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. Fixed assets of R530 151 had incorrectly been accounted for as repairs and maintenance. Therefore, repairs are overstated and fixed assets are understated and the accumulated surplus overstated by R530 151

Personnel expenditure

31. Personnel expenditure included in notes 20 and 21 to the financial statements amounts to R85 894 989. As a result of the audit matters detailed below I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of the personnel expenditure and the municipality's records did not permit the application of alternative audit procedures in this regard.

- (a) The municipality could not provide explanations or supporting documentation for a difference of R2 765 793 between the financial statements and the municipality's payroll records.
- (b) Supporting documentation could not be provided for other allowances of R2 913 670 included in note 20 to the financial statements.
- (c) Supporting documentation in respect of the calculation of car allowances of R4 412 216, included in note 20 to the financial statements could not be provided.
- (d) Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reasons for the reclassification of comparative disclosures was not included in the financial statements. The corresponding amount for employee-related expenses was adjusted from R78 991 100 to R81 464 124 in the 30 June 2010 financial statements.

Bulk purchases

32. Bulk purchases amounting to R34 112 662 (2009: R45 681 554) were recognised in the statement of financial performance. Management could not provide 17 invoices which relate to the purchase of bulk electricity. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of electricity expenses.

General expenditure

33. General expenditure of R73 256 527 (2009: R72 157 181) was disclosed in note 19 to the financial statements. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure. The municipality's records did not permit the application of alternative audit procedures and accordingly, I could not obtain sufficient appropriate audit evidence to confirm the occurrence, completeness and accuracy of general expenditure.
- (a) Supporting documentation could not be obtained in respect of travel and subsistence allowances of R1 456 112 included under general expenditure in note 19 of the financial statements.
 - (b) Fuel and oil expenses of R3 907 584 were included under general expenditure in note 19 of the financial statements, but supporting documentation for fuel and oil expenses of R2 664 168 could not be obtained.
 - (c) Consulting and professional fees of R6 665 593 were included under general expenditure in note 19 to the financial statements, but supporting documentation for expenses of R1 557 713 could not be obtained.
 - (d) Lease rentals of R2 826 389 and contracted services of R1 997 971 were included under general expenditure in the financial statements. Supporting documentation for expenses amounting to R574 633 could not be obtained, resulting in a projected misstatement of R3 251 677.
 - (e) Other expenditure of R6 719 805 was included in general expenditure in note 19 to the financial statements. Supporting documentation for expenses amounting to R482 621 could not be provided, resulting in a total projected misstatement of R2 094 613.
 - (f) Grant expenditure of R16 388 822 is included under note 19 to the financial statements. Supporting documentation for grant expenses amounting to R10 511 731 could not be provided.
 - (g) I was unable to obtain sufficient appropriate audit evidence for debit journals of R6 115 468 and credit journals of R690 000. I was unable to test the completeness, accuracy and validity of the journals processed against general expenditure.
34. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:
- (a) Departmental expenses of R2 578 076 were included in general expenditure in note 19 to the financial statements, while departmental expenses and the corresponding departmental income should net off to a nil balance. Consequently, general expenses were overstated by R2 578 076. Due to the lack of audit evidence I could not determine the effect thereof on the other account balances or classes of transactions reported in the financial statements.
 - (b) Consulting and professional fees were overstated by R319 839, which resulted in a projected error of R2 496 570
35. Contrary to the requirements of GRAP 1, disclosure of the nature and amount of and the reason for the reclassification of comparative disclosures was not included in the financial statements. Management could not provide me with sufficient appropriate audit evidence to enable me to audit these restatements of the comparative information. Consequently, I could not perform alternative procedures to obtain sufficient appropriate audit evidence of these restatements. The comparative disclosure for the following captions was adjusted in the 30 June 2010 financial statements:
- Finance costs were adjusted from R4 005 793 to R4 725 212;

- Collection costs were adjusted from zero to R742 866;
- Contracted services were adjusted from R1 982 466 to R3 309 111;
- General expenses were adjusted from R84 102 945 to R72 157 181;
- Loss on disposal of assets was adjusted from zero to R1 080 624; and
- Donated PPE was adjusted from R46 806 979 to zero.

Unauthorised, fruitless and wasteful and irregular expenditure

36. I was unable to obtain sufficient appropriate audit evidence to confirm the occurrence and accuracy of irregular expenditure amounting to R1 320 460 as disclosed in note 31 to the financial statements. There were no alternative procedures I could perform in order to obtain the audit evidence I required.
37. Procurement documentation for expenses amounting to R2 583 370 (2009: 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.
38. Paragraph 18 of GRAP 1 requires financial statements to fairly present the financial position, financial performance and cash flows of the municipality. The following misstatements were identified:
- (a) The municipality did not disclose in full the following fruitless and wasteful expenditure totalling R17 227 632 (2009: R145 056) in the financial statements, as required by section 125(2)(d) of the MFMA:
- The municipality incurred fruitless and wasteful expenditure as a result of duplicate annual bonus payments amounting to R86 (2009: R3 363), excessive overtime payments amounting to R12 902 (2009: R1 927) and payments made to deceased employee amounting to R16 957.
 - Additional interest charged amounting to R273 002 (2009: R100 220) with respect to the late payment of instalments on long-term liabilities.
 - Additional interest and penalties amounting to R1 585 558 with respect to the late payment of amounts due to SARS.
 - Additional interest amounting to R15 339 127 with respect to the late payment of bulk purchases.
- (b) Irregular expenditure amounting to R177 993 in respect of the misuse of municipal garage cards during 2010 was not disclosed in the financial statements. Irregular expenditure amounting to R1 391 254 in respect of the misuse of municipal garage cards during 2009 was incorrectly disclosed as fruitless and wasteful expenditure.
- (c) Irregular expenditure incurred due to non-compliance with the supply chain management policy amounting to R2 274 693 (2009: R2 412 464) was not disclosed in the financial statements.
- (d) Contrary to sections 1, 15 and 32 of the MFMA, budgeted expenditure of R79 748 882 was exceeded on certain votes by R168 885 987 (2009: 22 429 579) and was not disclosed in the financial statements as unauthorised expenditure, as required by section 125(2)(d) of the MFMA.

Going concern

39. 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 its consumer debtors 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 in terms of section 138 of the MFMA. The financial statements did not disclose any details of the uncertainty and had been prepared on a going concern basis. The municipality's accounting records did not provide me with sufficient appropriate audit evidence that the municipality is able to continue as a going concern.

Disclaimer of opinion

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

Additional matters

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

Unaudited supplementary schedules

41. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

42. 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 key laws and regulations [MFMA, and the Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA)] and financial management (internal control).

Predetermined objectives

43. Material findings on the report on predetermined objectives are reported below:

Non-compliance with regulatory and reporting requirements

Existence and functioning of a performance audit committee

44. The Ngwathe Local Municipality did not have a functional performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

45. The internal audit processes and procedures did not include assessments of the functionality of the Ngwathe Local Municipality's performance management system and performance measurements to ensure reliability and compliance with the MSA.

Lack of adoption or implementation of a performance management system

46. The municipality does not have a functional performance management system as required by section 38(a) of the MSA.

Lack of effective, efficient and transparent systems and internal controls regarding performance management

47. 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.
48. Evidence could not be obtained regarding proper public participation in the compilation and adoption of the integrated development plan, as required by sections 25 and 28 and regulation 15(3) of the MSA.
49. 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.
50. 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 sections 42 and 43 of the MSA as well as certain regulations linked to these sections.

Usefulness of 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

51. The Ngwathe Local Municipality has not reported throughout on its performance against predetermined objectives, indicators and targets which are consistent with the approved IDP.

Reliability of 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: Have the amounts, numbers and other data relating to reported actual performance been recorded appropriately?
- Completeness: Have the actual results and events that should have been recorded been included in the reported performance information?

The following audit findings relate to the above criteria

Reported indicators not reliable as no supporting source information was provided

52. Sufficient appropriate audit evidence in relation to any of the selected objectives could not be obtained. There were also no other satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information.
53. Furthermore, it was determined that 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.

Compliance with laws and regulations

Municipal Finance Management Act

The audit committee was not properly established

54. The municipality did not have a functioning audit committee, as prescribed by sections 165(2)(b) and 166 of the MFMA.

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

55. No evidence could be obtained that irregular expenditure identified had been investigated and that political office bearers or officials of the municipality who deliberately or negligently incurred or authorised irregular expenditure were held liable for such expenditure in terms sections 32(1)(c) and 32(2)(b) of the MFMA.

The accounting officer did not adhere to his statutory responsibilities

56. Contrary to the requirements of section 62(1)(c) of the MFMA and Treasury Regulation 27.2.1, the municipality did not have a fraud prevention plan.
57. Management could not provide me with sufficient appropriate audit evidence to confirm that all payroll expenditure had been reported to council, as required by section 66 of the MFMA.

The financial statements were not prepared in accordance with applicable legislation

58. Contrary to the requirements of section 78(1) of the MFMA, senior managers did not take all reasonable steps to ensure that the system of financial management and internal control established for the municipality is carried out diligently to ensure the accurate and correct recording of all transactions.
59. Contrary to the requirements of section 64 of the MFMA, the accounting officer did not fulfil his responsibilities towards ensuring that all revenue is collected and accounted for.
60. Contrary to the requirements of section 124 of the MFMA, the remuneration of key personnel was not accurately disclosed in the financial statements.
61. Contrary to the requirements of section 122 of the MFMA, the municipality did not prepare financial statements which fairly present the state of affairs of the municipality, its performance against its budget, its management of revenue, expenditure, assets and liabilities, its business activities, its financial results and its financial position as at the end of the financial year.

62. Contrary to the requirements of section 96 of the MFMA, the accounting officer did not effectively manage the assets and liabilities of the municipality by implementing proper controls over the recording and safeguarding of assets. Contrary to the requirements of sections 63 and 99 of the MFMA, the accounting officer did not maintain a management accounting and information system that accounts for all the assets and liabilities of the municipality.
63. Non-compliance with the MFMA had not been disclosed in the financial statements as required by section 125 of the MFMA.
64. All suspense accounts had not been cleared at year-end, as required by section 65(2)(j) of the MFMA.

Expenditure was not paid within the parameters set by the applicable legislation

65. Expenditure was not paid within the required 30 days from the receipt of an invoice/account, as required by section 65(2)(e) of the MFMA.

Supply chain management legislative requirements were not implanted or not adhered to

66. Contrary to the requirements of sections 60 and 62 of the MFMA, I identified various instances of unauthorised, irregular and fruitless and wasteful expenditure. No policy exists for this expenditure. I also identified instances where proper records of the financial affairs were not kept by the municipality.

The mayor did not adhere to his legislative responsibilities

67. The mayor did not consider the revision of the service delivery and budget implementation plan on receipt of the monthly budget statements as required by section 54(1)(c) of the MFMA.

The annual budget was not prepared, tabled and approved in accordance with the applicable laws and regulations

68. Contrary to the requirements of sections 53 and 69 of the MFMA, I was unable to obtain an approved service delivery or budget implementation plan.

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

69. Contrary to the requirements of section 15 of the MFMA, the municipality incurred expenses in excess of the approved budget.

Municipal Systems Act

The accounting officer did not adhere to his statutory responsibilities

70. Management could not provide me with sufficient appropriate audit evidence to verify compliance with sections 56 and 57 of the MSA regarding appointment and performance agreements of management.

Inadequate content of integrated development plan

71. The strategic objectives in the strategic plan and the integrated development plan are not consistent and had not been linked to the annual budget, as required by regulation 6(a) of the MSA.
72. The integrated development plan of Ngwathe Local Municipality did not include adequate key performance indicators, performance targets and a financial plan with a budget projection for the next three years, as required by sections 26(i) and 41(1)(b) of the MSA.

INTERNAL CONTROL

73. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA and MSA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
74. 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

- Accountability to the public is not emphasised.
- Quality is not understood by all to be a prerequisite and is not embedded in the municipality's values.
- Performance is not adequately measured.

Oversight responsibility

- The accounting officer does not adequately exercise oversight responsibility over reporting and compliance with laws and regulations and internal control.
- Not all the systems are documented in the policy and procedures manual and the results of the monitoring process are not routinely communicated to all managers and staff.
- An effective organisational structure that places people with appropriate skills is not established.
- The accounting officer does not sufficiently evaluate whether management has implemented effective internal controls by gaining an understanding of how senior management has met its responsibilities.

Corrective action

- Actions are not taken to address risks relating to the achievement of complete and accurate financial and performance reporting.
- Control weaknesses are not properly analysed, and appropriate follow-up actions are not sufficiently implemented to address root causes.
- Not all internal and external audit findings are addressed.

Financial and performance management

- The municipality does not have sufficient competent individuals who understand the financial reporting framework and performance management requirements.
- Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting.
- The financial statements and performance information were subject to material amendments resulting from the audit.
- The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.
- Requested information was not available and supplied without any significant delay.

Adequate financial management systems

- General information technology controls are not designed to maintain the integrity of the information systems and the security of the data.
- Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.
- Systems are not appropriate to facilitate the preparation of the financial statements and performance reports.

Governance

Risk identification and management

- The municipality does not have a formal risk assessment process.
- The municipality does not identify risks relating to the achievement of financial and performance reporting objectives.
- The risk of material misstatement due to fraud is not considered.
- The municipality does not assess the likelihood and impact of risks identified.
- The municipality does not respond to the assessed risks by determining a risk strategy / action plan to manage identified risks.
- Internal controls are not selected and developed to prevent/detect and correct material misstatements in financial reporting and reporting on predetermined objectives.

Fraud prevention, detection and response

- Segregation of duties to prevent fraudulent data and asset misappropriation is not adequate.
- A fraud prevention plan is not documented and used as per the requirements of applicable legislation.

Internal audit that inspects the adequacy and implementation of internal control

- Internal audit does not fully operate in accordance with approved written terms of reference.

Audit committee that promotes independent accountability and service delivery

- Audit committee did not operate in accordance with approved written terms of reference.
- The audit committee did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice.
- Implementation of internal and external audit recommendations is not monitored.
- Financial statements and performance reports are not reviewed prior to submission for audit.

Bloemfontein

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence