

FINAL REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MANGAUNG METROPOLITAN MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying consolidated and separate financial statements of the Mangaung Metro Municipality, which comprise the consolidated and separate statement of financial position as at 30 June 2011, the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010) (DoRA), and for such internal control as management determines necessary to enable the preparation of consolidated and separate 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 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these consolidated and separate financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion

Basis for disclaimer of opinion

Property, plant and equipment

4. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation, presentation and disclosure of, as well as rights to, property, plant and equipment with a carrying value of R4 248 358 303 (2010: R4 265 928 393), as disclosed in note 13 to the consolidated financial statements and R3 057 706 513 (2010: R2 968 447 567), as disclosed in note 13 to the separate financial statements. Consequently, I could not confirm the accuracy, completeness and occurrence of depreciation charges on property, plant and equipment amounting to R288 056 329 (2010: R168 256 851), as presented in the consolidated statement of financial performance and R140 848 150 (2010: R123 024 585), as presented in the separate statement of financial performance. The municipality's records did not permit the performance of reasonable alternative audit procedures.
 - a) The descriptions, serial numbers and locations of assets recorded in the fixed asset register were inadequate to identify property, plant and equipment with a carrying value of R875 490 141 (2010: R4 320 410 094), as disclosed in note 13 to the consolidated financial statements and R845 585 322 (2010: R1 542 135 210) in the separate financial statements. In addition, certain assets physically identified during the audit could not be traced to the fixed asset register. Furthermore, management did not

conduct a complete asset verification during the year. This matter was also reported in the previous year.

- b) The fixed asset register of the municipality was being reconstructed during the current financial year by an expert to value the assets in terms of Directive 7. The input data and assumptions used by the expert to value items of property, plant and equipment with a carrying value of R102 691 633, as disclosed in note 13 to the consolidated and separate financial statements, could not be confirmed. Sufficient appropriate audit evidence could not be provided in time for audit purposes to substantiate whether the expert's valuation methodology was appropriately and consistently applied.
- c) I could not confirm that journals that decreased property, plant and equipment and accumulated surplus by R142 573 441 and R276 293 599, respectively, in the consolidated and separate financial statements should have been processed or had been recorded in the correct accounts and at the correct amounts, as they were not supported by sufficient appropriate audit evidence.
- d) Property, plant and equipment amounting to R181 378 061 acquired for infrastructure projects during the financial year could not be traced to the fixed asset register. It was therefore not possible to confirm that these assets had been appropriately recognised in the consolidated and separate financial statements in terms of paragraph 11 of SA Standards of GRAP, *Property, Plant and Equipment* (GRAP 17). In addition, sufficient appropriate audit evidence could not be provided to confirm property, plant and equipment additions amounting to R40 385 093 (2010: R9 739 899) included in note 13 to the consolidated financial statements and R36 268 915 included in the separate financial statements. This matter was also reported in the previous year.
- e) Paragraph 53 of GRAP 17 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. Paragraphs 61 and 71 require the municipality to review its assets' residual values and useful lives and the depreciation method used at least at each reporting date. The parent municipality and municipal entity did not comply with these requirements in the current and previous year. Due to the lack of sufficient appropriate audit evidence, the total financial impact on the consolidated and separate financial statements could not be determined. This matter was also reported in the previous year.
- f) The accounting policy of the municipality as set out in accounting policy note 2.14 requires that property, plant and equipment must be assessed for impairment at each reporting date. Management of the parent municipality did not assess whether there had been a decrease in the value of property, plant and equipment during the current and previous years. Due to the lack of sufficient appropriate audit evidence, the total financial impact on the consolidated and separate financial statements could not be determined. This matter was also reported in the previous year.
- g) A total of 1 452 erven, which conform to the definition and recognition criteria of property, plant and equipment as stated in paragraph 11 of GRAP 17 and which were identified as municipal property on the erven listing, were not accounted for as property, plant and equipment by the parent municipality. Consequently, property, plant and equipment and the accumulated surplus in the consolidated and separate financial statements were understated. Due to the lack of sufficient appropriate audit evidence, it was impracticable to determine the total extent of this understatement.
- h) The municipality did not disclose comparative information for additions, revaluations, work in progress, disposals and other changes in each class of property, plant and equipment, as required by paragraph 82 of GRAP 17. This is mainly due to the fact that a reconciliation was not performed between the previous asset register and the current asset register, which was entirely reconstructed. Due to the lack of sufficient appropriate audit evidence, it was impracticable to determine the total extent of this misstatement in the comparative information of property, plant and equipment and prior

period errors disclosed in note 59 to the consolidated and separate financial statements.

- i) Assets under construction were not identified and disclosed separately in the financial statements by the municipal entity, as required by paragraph 83(b) of GRAP 17. This resulted in the overstatement of property, plant and equipment and understatement of work in progress in note 13 to the consolidated financial statements. The municipal entity did not comply with these requirements in the current and the previous years.
- j) According to SA Standards of GRAP, GRAP 5, *Borrowing costs*, prior period borrowing costs as included in finance costs in the statement of financial performance should be capitalised as part of the cost of the underlying assets. Due to weaknesses identified in the fixed asset register of the municipal entity, borrowing costs amounting to R12 990 386 of the previous year included in note 43 to the consolidated financial statements, could not be confirmed. Previous year net finance cost is therefore overstated and property, plant and equipment understated by an unknown amount in the consolidated financial statements.
- k) Misclassification of transactions between accounts occurred which resulted in property, plant and equipment disclosed in note 13 to the consolidated financial statements being understated, and repairs and maintenance in the consolidated statement of financial performance being overstated by R6 266 599.

Revenue

- 5. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, accuracy, occurrence, classification and cut-off of service charges revenue relating to the sale of electricity disclosed in note 33 to the consolidated financial statements as R1 130 497 111 (2010: R926 979 708). Due to weaknesses in the accounting records, no alternative audit procedures could be performed in this regard:
 - a) Sufficient appropriate audit evidence to substantiate electricity meter device readings of R402 513 460 (2010: R385 101 122) as levied in the debtors sub-ledger could not be submitted for audit purposes by the municipal entity. This matter was also reported in the previous year.
 - b) Sufficient appropriate audit evidence regarding the completeness of sale of electricity for the year under review could not be obtained. Due to the limitations involved the financial impact thereof could not be determined.
 - c) Sufficient appropriate audit evidence regarding the accuracy of electricity meter reading estimates as at year-end for the current and previous year could not be submitted for audit purposes by the municipal entity. Due to the limitations involved the financial impact thereof could not be determined. This matter was also reported in the previous year.
 - d) Sufficient appropriate audit evidence for the calculation of the levies charged for street and traffic light consumption amounting to R1 571 034 (2010: R10 065 990) could not be provided by the municipal entity. This matter was also reported in the previous year.
 - e) I was unable to obtain sufficient appropriate audit evidence to enable me to confirm the classification between prepaid electricity sales totalling R222 285 673 (2010: R180 089 183) and free services recoverable revenue in the financial statements of the municipal entity. Consequently, I was unable to confirm the occurrence, accuracy and classification of this service revenue from electricity sales included in note 33 to the consolidated financial statements.
 - f) Electricity usage differences totalling R62 609 871 in value were identified between the system and the underlying meter reading books in the previous year. As a result, I was unable to confirm the occurrence and accuracy of sale of electricity revenue of the

previous year as disclosed in note 33 to the financial statements. Had the electricity usage in units been captured correctly on the system, the effect would have been to decrease service charges by an amount of R62 609 871, increase the VAT receivable by R8 765 382 and decrease consumer receivables by R71 375 253 in the consolidated financial statements.

- g) Sufficient appropriate audit evidence for revenue from public contributions to the amount of R11 706 336 (2010: R12 267 290) as included in the consolidated statement of financial performance could not be obtained.
6. Sufficient appropriate audit evidence could not be obtained to confirm service charges relating to the sale of water amounting to R61 100 989, as included in service charges disclosed in note 33 to the consolidated and separate financial statements, as meter reading books could not be provided for audit purposes. The parent municipality's records did not permit the application of reasonable alternative procedures. Consequently, I could not obtain adequate audit assurance as to the occurrence, accuracy and completeness of this service charges revenue.
7. Sufficient appropriate audit evidence to confirm the accuracy of water meter reading estimates as at year-end could not be obtained. Due to the limitations involved, the total financial impact thereof could not be determined. The parent municipality's records did not permit the application of reasonable alternative audit procedures. Consequently, I could not obtain adequate audit evidence as to the occurrence, accuracy and completeness of this service charges revenue, as disclosed in note 33 to the consolidated and separate financial statements.
8. It could not be confirmed that journals, which increased revenue by R4 697 449 and R8 860 129 in the current and previous year, respectively, and decreased revenue by R33 311 120 and R4 619 125 in the current and previous year, respectively, as disclosed in the consolidated and separate statements of financial performance, should have been processed or had been recorded in the correct accounts and at the correct amounts, as the municipality could not provide sufficient appropriate audit evidence for these journals. In addition, I could not confirm that journals which decreased revenue by R23 827 223 in the previous year, as disclosed in the consolidated statement of financial performance, should have been processed or had been recorded in the correct accounts and at the correct amounts, as the municipal entity could not provide me with sufficient appropriate audit evidence for these journals. Weaknesses in the parent municipality's and municipal entity's accounting records did not permit the application of reasonable alternative procedures.
9. Revenue was incorrectly recognised on services rendered to indigent consumers, as these transactions did not conform to the recognition requirements in SA Standards of GRAP, GRAP 9, *Revenue from Exchange Transactions*, which resulted in revenue and consumer receivables from exchange transactions being overstated in the current and previous years. On subsequent measurement, this indigent debt was impaired and recognised as part of the provision for bad debt as disclosed in the consolidated and separate statements of financial performance. Consequently, service charges revenue and the provision for bad debt were overstated for the current and previous years in the consolidated and separate financial statements. Due to the lack of sufficient appropriate audit evidence, it was impracticable to determine the total extent of this understatement.

Consumer receivables

10. Gross consumer receivables of the previous year amounting to R221 494 581 included in note 9 to the consolidated financial statements have not been impaired in accordance with the requirements of South African Statement of Generally Accepted Accounting Practice, IAS 39: *Financial instruments: Recognition and measurement* (IAS 39). The municipal entity had only made a general provision in the previous year for doubtful receivables totalling R48 002 191. As the relevant information was not available, I was not able to determine what the impairment charge of the previous year should have been had IAS 39

been applied correctly. I was therefore unable to quantify the amount by which consumer receivables, provision for bad debts, and accumulated surplus of the previous year are misstated in the consolidated financial statements. No reasonable alternative procedures could be performed. This matter was also reported in the previous year.

11. Included in the balance of consumer debtors, as disclosed in note 9 to the consolidated and separate financial statements, were suspense accounts for unallocated deposits with a credit balance of R8 154 807 (2010: R11 546 808). These unallocated deposits represent receipts that had not yet been allocated to the relevant financial statement line items as at year end. As these payments have not been adequately allocated subsequent to year-end, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness, valuation and the municipality's rights to, consumer and other receivables as disclosed in note 9 and 7 to the consolidated and separate financial statements, respectively and the completeness, accuracy and classification of other income as disclosed in note 37 to the consolidated and separate financial statements. This matter was also reported in the previous year.
12. Sufficient appropriate audit evidence could not be obtained to confirm the existence of consumer receivables with a gross balance of R38 321 809 (2010: R37 899 524), as included in consumer receivables disclosed in note 7 to the consolidated financial statements and R9 984 312 in the separate financial statements. The municipality's records did not permit the application of reasonable alternative procedures. Consequently, I did not obtain all the evidence I considered necessary to satisfy myself as to the existence of these receivables. This matter was also reported in the previous year.
13. Supporting documentation for debit transactions amounting to R5 339 236 and R19 021 898, recorded by the municipal entity against the provision for bad debt and receivable accounts, respectively could not be provided to enable me to confirm the validity and accuracy of these transactions in the consolidated financial statements.

Expenditure

14. Sufficient appropriate audit evidence could not be obtained to confirm the accuracy and occurrence of expenditure transactions amounting to R112 782 681 and R76 334 835 as disclosed in the consolidated and separate statements of financial performance, respectively. The system of control over the recording and classification of expenditure was not adequate, with the result that there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all of these expense transactions occurred and had been accurately recorded and classified in the financial records of the municipality.

Trade and other payables

15. In accordance with paragraph 37 of the SA Standards of GRAP: *Framework for Preparation and Presentation of Financial Statements*, the financial statements should be prepared on the accrual basis. On this basis, transactions are recognised when they occur. Transactions are therefore recorded in the accounting records and reported in the financial statements of the periods to which they relate. However, various payments made by the parent municipality to suppliers and/or service providers after year-end pertained to the current year. These payments were not recognised in the current year, resulting in the understatement of trade payables and expenditure in the consolidated and separate financial statement. The parent municipality's records did not permit me to determine the total extent of this misstatement.
16. The municipal entity has applied for exemption from normal tax as per section 10(1)(c)(A) of the Income Tax Act of South Africa, 1962 (Act No. 58 of 1962). As at year-end the entity had not yet been granted exemption from normal tax by the Commissioner of the South African Revenue Service. In the absence of the above exemption, the entity had a present legal obligation to recognise a current tax liability as well as a deferred tax liability as

required by SA Statement of Generally Accepted Accounting Practice, IAS 12, *Income taxes*. This matter was also reported in previous financial years. Management of the municipal entity disclosed the matter as a contingent liability, which is included in note 50 to the consolidated financial statements. However, the appropriate disclosure should be an accrual. Due to the material effect of scope limitations, misstatements and other issues of non-compliance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions* (GRAP 9), GRAP 17 and IAS 39 referred to in this report, I was unable to quantify the extent by which the income tax liability, deferred tax, accumulated surplus and income tax expense were misstated in this regard in the consolidated financial statements.

17. Finance cost amounting to R33 445 757 was not recognised in the separate financial statements on the Centlec intercompany loan. Consequently, payables from exchange transactions, as disclosed in note 19 to the separate financial statements, and finance cost as disclosed in note 43 to the separate financial statements are understated by R33 445 757.
18. With regard to trade and other payables amounting to R20 580 420 included in note 19 to the consolidated financial statements, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation thereof. Weaknesses in the municipal entity's records did not permit the application of reasonable alternative audit procedures.

Other financial assets

19. Interest earned on the shareholder's loan granted by the parent municipality to the municipal entity as disclosed in note 36 to the separate financial statements was not calculated in terms of the addendum to the loan agreement signed on 29 July 2010 between the parent municipality and the municipal entity. This resulted in interest received and other financial assets, as disclosed in note 5 to the separate financial statements, being overstated by R46 649 890.
20. The municipal entity could not provide signed loan agreements in respect of loans granted as funding for capital purchases made by the municipal entity on behalf of other local municipalities in the Free State. Consequently, I could not obtain sufficient appropriate audit evidence on the valuation of both the long-term and short-term portions of other financial assets, included in note 5 to the consolidated financial statements, with closing balances at year-end of R4 090 615 (2010: R4 579 416) and R488 804 (2010: R497 348), respectively.

Consumer deposits

21. Sufficient appropriate audit evidence could not be submitted to enable me to confirm the completeness, accuracy and existence of electricity consumer deposits amounting to R46 331 130 (2010: R38 368 918) as disclosed in note 22 to the consolidated financial statements. Weaknesses in the municipal entity's financial records did not permit the application of reasonable alternative audit procedures. This matter was also reported in the previous year.

Inventory

22. Prior year inventory amounting to R44 301 665, as disclosed in note 4 to the consolidated financial statements, was not carried at the lower of cost or net realisable value, as required by SA Standards of GRAP, GRAP 12, *Inventories* and in line with accounting policy note 2.13. Due to weaknesses in the recording of inventory items and the volume thereof, I could not quantify the extent by which inventory, operating expenses and accumulated surplus have been misstated in the consolidated financial statements. This matter was also reported in the previous year.

Other receivables

23. Sufficient appropriate audit evidence could not be obtained to confirm the existence of sundry receivables and deferred lease income receivables with gross balances of R45 806 941 and R44 433 162, respectively, included in other receivables as disclosed in note 5 to the consolidated and separate financial statements. The parent municipality's records did not permit the application of reasonable alternative procedures.

VAT receivable

24. Due to the material effect of scope limitations, misstatements and non-compliance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions* and IAS 39, referred to in this report, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness and valuation of the value-added tax (VAT) receivable amounting to R21 408 869 (2010: R19 162 271) as disclosed in note 8 to the consolidated financial statements.

Defined benefit plan obligation

25. Sufficient appropriate audit evidence could not be obtained in time to confirm the existence, valuation and completeness of long-service leave benefits amounting to R16 629 837 included in note 24 to the consolidated and separate financial statements. The municipality's records did not permit the application of reasonable alternative procedures.

Investment property

26. Paragraph 5 of GRAP 16 requires an asset to be recognised as investment property when it is property held to earn rentals or for capital appreciation, or both. Paragraphs 2 and 18 of GRAP 16 require a municipality to disclose investment property separately in the financial statements. Management of the parent municipality did not complete their processes of separating investment property from property, plant and equipment in the current and previous year. Consequently, I could not obtain adequate audit assurance as to the completeness, valuation and existence of investment property and property, plant and equipment in the consolidated and separate financial statements for the current and previous year.

Heritage assets

27. Paragraph 6 of GRAP 17 requires a municipality to disclose heritage assets separately in the financial statements. Management of the parent municipality has not completed its processes regarding the identification of heritage assets for separate disclosure in the financial statements. Consequently, I could not obtain adequate audit assurance as to the completeness, valuation as well as presentation and disclosure of heritage assets amounting to R5 601 720 (2010: R3 416 928) as disclosed in note 11 to the consolidated and separate financial statements.

Capital commitments

28. Paragraph 83(c) of GRAP 17 states that the financial statements shall disclose for each class of property, plant and equipment recognised in the financial statements, the amount of contractual commitments in this regard. The commitment register to support commitments amounting to R203 042 374 (2010: R532 981 188) included in note 49.1 to the consolidated and separate financial statements was not complete, did not always agree to supporting contracts and were not mathematically accurate. All active contracts were not taken into consideration and commitments recognised did not always represent actual commitments as at year-end. It was not possible to determine the total extent of this misstatement in the consolidated and separate financial statements due to the unavailability of supporting documentation. This matter was also reported in the previous year.

29. As a result of weaknesses in the contract management system as well as insufficient supporting documentation, the existence, accuracy and completeness of capital commitments amounting to R69 513 083 (2010: R784 220), included in note 49.1 to the consolidated financial statements could not be confirmed.

Additional disclosures in terms of the MFMA

30. The completeness and accuracy of distribution losses totalling R130 533 189 (2010: R140 595 651), as disclosed in note 79 to the financial statements, could not be confirmed as no supporting documentation could be provided to substantiate the calculation. The municipal entity's records did not permit the application of reasonable alternative procedures.

Contingent liabilities

31. Sufficient appropriate audit evidence could not be obtained to confirm the existence of contingent liabilities amounting to R37 695 913 (2010: R3 476 000) and R5 601 913 included in note 50 to the consolidated and separate financial statements, respectively. Furthermore, sufficient appropriate audit evidence could not be obtained to confirm the completeness and valuation of contingent liabilities. I was unable to perform reasonable alternative audit procedures. Consequently, I could not obtain adequate audit assurance as to the existence, valuation and completeness of contingent liabilities as disclosed in note 50 to the consolidated and separate financial statements. This matter was also reported in the previous year.

Irregular expenditure

32. Sufficient appropriate audit evidence could not be provided that all irregular expenditure transactions had been identified, investigated and recorded during the year under review. Due to the limitations placed on the scope of the work performed relating to expenditure and property, plant and equipment procurement, there were no satisfactory alternative audit procedures that could be performed. Consequently, I could not obtain adequate audit assurance as to the accuracy and completeness of irregular expenditure amounting to R148 765 509 (2010: R102 477 912) and R108 427 595 (2010: R58 007 376) as disclosed in note 78 to the consolidated and separate financial statements, respectively. This matter was also reported in the previous year.
33. Section 1 of the MFMA defines irregular expenditure as expenditure incurred by a municipality that is not in accordance with a requirement of the act and that has not been condoned in terms of section 170. Irregular expenditure amounting to R25 964 014 was identified, which resulted from non-compliance with the parent municipality's supply chain management (SCM) policy. This irregular expenditure was not disclosed as required by section 125(2)(d) of the MFMA and therefore irregular expenditure as disclosed in note 78 to the consolidated and separate financial statements was understated by R25 964 014.

Fruitless and wasteful expenditure

34. I was not provided with sufficient, appropriate audit evidence that management had properly identified, investigated and recorded all fruitless and wasteful expenditure transactions during the current and previous year. Due to the limitations placed on the scope of the work performed relating to expenditure, there were no satisfactory alternative audit procedures that I could perform to confirm the completeness of fruitless and wasteful expenditure amounting to R40 953 136 (2010: R19 209 989) and R11 836 142 (2010: R6 431 068) as disclosed in note 77 to the consolidated and separate financial statements, respectively. This matter was also reported in the previous year.

Cash flow statement

35. I was unable to confirm that the consolidated and separate cash flow statements and the related notes were fairly stated due to the material effect on the consolidated and separate

cash flow statements and related notes of scope limitations and identified misstatements as reported in this report. This matter was also reported in the previous year.

Disclaimer of opinion

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

Emphasis of matters

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

Significant uncertainties

37. As disclosed in note 50 to the consolidated and separate financial statements, the municipality is party to contractual claims by its suppliers that are subject to mediation. The maximum potential liabilities are estimated at R56,77 million (2010: R82,06 million) and R82,27 million (2010: R78,57 million), respectively. The ultimate outcome of these claims could not be determined at year-end.

Restatement of corresponding figures

38. As disclosed in notes 53 to 72 to the consolidated and separate financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during the 2010-11 financial year in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2010.

Material losses

39. As disclosed in note 79 to the consolidated financial statements, material electricity and water losses amounting to R130 533 189 and R114 210 909, respectively, were incurred by the municipality mainly due to the deterioration of the electricity and water reticulation systems and illegal electricity and water connections.

Material impairments

40. As disclosed in note 5 to the consolidated and separate financial statements, a provision for a decrease in value to the amount of R56 238 182 (85,98%) (2010: R40 600 245) (66,17%) was made with regard to housing selling scheme loans, erven loans, vehicle loans and study loans amounting to R65 407 129 (2010: R61 359 562).
41. As disclosed in note 6 to the consolidated and separate financial statements, a provision for a decrease in value to the amount of R33 902 241 (48,69%) (2010: R31 636 314) (48,37%) was made with regard to amounts owing to the parent municipality in respect of commercial rental income and other miscellaneous services rendered by the parent municipality amounting to R69 626 160 (2010: R65 405 724).
42. As disclosed in note 9 to the consolidated and separate financial statements, a provision for a decrease in value to the amount of R872 678 281 (71,81%) (2010: R817 618 046) (71,47%) and R750 011 181 (78,94%) (2010: R769 615 855) (83,43%), respectively, was made with regard to amounts owing to the municipality in respect of electricity, water and sanitation services rendered by the municipality, housing rentals and rates and taxes amounting to R1 215 247 624 (2010: R1 143 989 733) and R950 055 364 (2010: R922 495 152), respectively.

Financial sustainability

43. As disclosed in note 74 to the consolidated and separate financial statements, certain going concern ratios are regarded as unfavourable. The current liabilities of the municipality

significantly exceed its current assets. The municipality did not settle its debt within 30 days as required by the MFMA and is significantly dependent on the national and provincial government for its continued sustainability. The municipality is experiencing serious difficulties with regard to debt collection. Furthermore, as disclosed in note 24 to the consolidated and separate financial statements, no funds have been set aside to settle defined benefit obligations amounting to R407 300 837 (2010: R350 917 000). The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business.

Irregular expenditure

44. As disclosed in note 78 to the consolidated and separate financial statements, irregular expenditure of R148 765 509 (2010:R102 477 912) and R108 427 595 (2010: R58 007 376), respectively, was incurred in the current and previous financial years mainly as a result of contracts awarded to suppliers in contravention of the Local Government: Municipal Supply Chain Management Regulations (GNR 868 of 30 May 2005) (Municipal SCM Regulations) and policies. Accumulated irregular expenditure amounting to R292 021 394 (2010: R143 255 885) and R207 212 944 (2010: R98 785 349), respectively, is awaiting condonement by the council.

Unauthorised expenditure

45. As disclosed in note 76 to the consolidated and separate financial statements, non-budgeted expenditure of R67 711 892 (2010: R56 213 592) was incurred during the current and previous financial years, which is regarded as unauthorised expenditure. The total reported unauthorised expenditure that was still under investigation at 30 June 2011 amounts to R466 793 278 (2010: R399 081 386). As disclosed in note 75 to the consolidated and separate financial statements, the council condoned an amount of R399 081 386 subsequent to year-end.

Fruitless and wasteful expenditure

46. As disclosed in note 77 to the consolidated and separate financial statements, fruitless and wasteful expenditure of R40 953 136 (2010: R19 209 989) and R11 836 142 (2010: R6 431 068), respectively, was incurred during the current and previous financial years as a result of the reasons set out in the note. The total reported fruitless and wasteful expenditure that was still under investigation at 30 June 2011 amounts to R62 959 647 (2010: R22 006 511) and R21 063 732 (2010: R9 227 590) respectively. As disclosed in note 75 to the consolidated and separate financial statements the council condoned an amount of R4 127 701 subsequent to year-end.

Additional matters

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

Material inconsistencies in other information included in the annual report

47. I have not obtained the other information included in the consolidated annual report and have not been able to identify any material inconsistencies with the consolidated and separate financial statements.

Unaudited supplementary schedules

48. The supplementary information set out in appendices A, C, D and F does not form part of the consolidated and separate financial statements and is presented as additional information. I have not audited these appendices.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

49. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages [xx] to [xx] and material non-compliance with laws and regulations applicable to the municipality.

Report on predetermined objectives

Presentation of information

50. The reported performance against predetermined objectives was deficient in respect of the following criterion:
- Performance against predetermined objectives was not reported using the National Treasury guidelines.

Reasons for major variances between planned and actual reported targets were not provided in the report on predetermined objectives

51. Adequate explanations were not provided for major variances between the planned and the actual reported targets for all the objectives, as required in terms of the relevant reporting guidance. In total, 100% of the reported targets with major variances were not explained.

Usefulness of information

52. The reported performance information was deficient in respect of the following criterion:
- Consistency: The reported objectives, indicators and targets are not consistent with the parent municipality's approved integrated development plan and the service delivery agreement between the parent municipality and the entity.
 - Relevance: There is no clear and logical link between the service delivery agreement objectives and the objectives, outcomes, outputs, indicators and performance targets as included in the parent municipality's integrated development plan.

Reported objectives, indicators and targets were not consistent when compared with the planned objectives, indicators and targets

53. Reported performance against predetermined objectives, indicators and targets was not consistent with the approved integrated development plan.

Inadequate service delivery agreement

54. Contrary to section 93B of the Municipal Systems Act, 2000 (Act No. 32 of 2000), the parent municipality did not by agreement with the entity establish annual performance objectives and key performance indicators for the entity to be included in the municipal entity's multi-year business plan. Key financial and non-financial performance objectives and measurement criteria were therefore not agreed with the parent municipality, as required by section 87(5)(d)(i) of the MFMA.

Reliability of information

55. The reported performance information was deficient in respect of the following criteria:
- Validity: The reported performance did not occur and does not pertain to the municipality.
 - Accuracy: The amounts, numbers and other data relating to reported actual performance have not been recorded and reported appropriately.
 - Completeness: All actual results and events that should have been recorded have not been included in the reported performance information.

The validity, accuracy and completeness of reported performance against indicators could not be confirmed as inadequate supporting source information was provided

56. For the selected objectives, the validity, accuracy and completeness of 92% of the reported targets could not be established, as sufficient appropriate audit evidence could not be provided.

Compliance with laws and regulations

Strategic planning and performance management

57. Contrary to the requirements of section 53(1) of the MFMA, the service delivery and budget implementation plan of the parent municipality was not approved within 28 days of the approval of the annual budget.
58. Supporting documentation could not be obtained to confirm that the accounting officer of the municipal entity had submitted the results of the assessment on the performance of the entity during the first half of the financial year to the board of directors of the entity and the parent municipality of the entity, as required by section 88(1)(b) of the MFMA.

Budgets

59. The parent municipality incurred expenditure in excess of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.

Consolidated annual financial statements and annual report

60. Contrary to the requirements of section 122(1) of the MFMA, the parent municipality and its municipal entity did not prepare financial statements which fairly present their state of affairs, their financial results and their financial position as at the end of the financial year. Had these corrections not been allowed, the consolidated and separate audit reports would have contained numerous qualification paragraphs in this regard.
61. The municipal council did not adopt an oversight report containing the council's comments on the consolidated annual report within two months from the date on which the 2009-10 consolidated annual report was tabled in the council, as required by section 129(1) of the MFMA. This is due to the fact that the oversight committee did not meet to deal with the consolidated annual report.

Audit committee

62. The shared audit committee of the parent municipality and municipal entity was only appointed on 17 December 2010. The audit committee of the parent municipality and municipal entity was therefore not functional for the entire year under review as required by section 166(1) of the MFMA.
63. As a result of the late establishment of the shared audit committee, the committee could not fulfil all functions as per the audit committee charter and as required by section 166 of the MFMA.

Procurement and contract management

64. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of between R10 000 and R200 000 had been procured by means of written price quotations obtained by the parent municipality from at least three different prospective providers, as per the requirements of SCM Regulation 17(a) and (c).
65. Goods and services with a transaction value of between R10 000 and R200 000 were procured by the municipal entity without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulations 17(a) & (c).

66. Goods and services with a transaction value above R200 000 were procured by the parent municipality and municipal entity without inviting competitive bids as per the requirements of SCM regulations 19(a) and 36(1).
67. Contracts were extended or modified by the parent municipality to the extent that competitive bidding processes were circumvented, contrary to the requirement of a fair SCM system in section 112 of the MFMA.
68. Sufficient appropriate audit evidence could not be obtained that awards by the parent municipality had been made to providers based on criteria similar to those stipulated in the original bid documents and were stipulated in the original bid documents as per the requirements of SCM regulations 21(b) and 28(1).
69. Sufficient appropriate audit evidence could not be obtained that awards were made by the parent municipality to providers whose tax matters had been declared by the South African Revenue Services to be in order, as required by SCM regulation 43.
70. The performance of contractors and providers was not monitored by the parent municipality and municipal entity on a monthly basis as required by section 116(2)(b) of the MFMA.
71. Awards were made by the parent municipality to suppliers that did not submit a declaration on their employment by the state or their relationship to a person employed by the state, as per the requirements of SCM regulation 13(c).
72. Awards were made by the parent municipality and municipal entity to providers whose directors/ principal shareholders are persons in the service of other state institutions, in contravention of the requirements of SCM regulation 44. Furthermore, the provider failed to declare that he/she is in the service of the state, as required by SCM regulation 13(c).
73. Awards were made by the parent municipality to providers who were persons in the service of the parent municipality, in contravention of SCM regulation 44.
74. Sufficient appropriate audit evidence could not be obtained that the preference point system had been applied by the parent municipality in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and SCM regulation 28(1)(a).
75. Sufficient appropriate audit evidence could not be obtained that awards by the parent municipality had been made to suppliers that scored the highest points in the evaluation process, as per the requirements of section 2(1)(f) of the Preferential Procurement Policy Framework Act of 2000.
76. Sufficient appropriate audit evidence could not be obtained that construction contracts had been awarded by the parent municipality and municipal entity only to contractors that were registered and qualified for the contract in accordance with the prescripts of the Construction Industry Development Board.
77. Section 111 of the MFMA and section 2(1) of the SCM regulations were not complied with as the municipal entity did not have an approved and implemented SCM policy, which resulted in the incurrence of irregular and fruitless and wasteful expenditure.
78. Quotations were accepted by the municipal entity from prospective providers who are not on the list of accredited prospective providers and do not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
79. Contrary to the requirements of section 105 of the MFMA, the municipality did not take all reasonable steps to ensure that any irregular, fruitless and wasteful expenditure and other losses were prevented.
80. Sufficient appropriate audit evidence could not be provided that contracts and quotations of the municipal entity to the value of R402 094 606 awarded and accepted in accordance with legislative requirements and the SCM policy.

81. Contracts were modified by the municipal entity without tabling the reasons for the proposed amendments in the council of the parent municipality, as required by section 116(3) of the MFMA.
82. The accounting officer of the municipal entity failed to implement measures to combat the abuse of the entity's SCM system as per the requirements of SCM regulation 38(1) because awards were made to providers for which the following could not be determined:
 - During the last five years, failed to perform satisfactorily on a previous contract with the municipality or entity or other organ of state;
 - Committed a corrupt or fraudulent act in competing for the contract;
 - Abused the SCM system of the municipality;
 - Had been convicted of fraud or corruption during the past five years.

Expenditure management

83. Payments to suppliers were not made within 30 days of receipt of the relevant invoice or statement by the parent municipality and municipal entity, as required by section 65(2)(e) and section 99(2)(b) of the MFMA, respectively.
84. The accounting officers of the parent municipality and municipal entity did not take reasonable steps to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) and section 95(d) of the MFMA, respectively.
85. The parent municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable person, as required by section 32(2) of the MFMA.
86. The accounting officer of the municipal entity did not take all reasonable steps to ensure that the municipal entity had and maintained a management, accounting and information system which recognised expenditure when it was incurred or accounted for creditors of the municipal entity as required by section 99(2)(c) of the MFMA.

Revenue management

87. Revenue received by the parent municipality and the municipal entity was not always reconciled at least on a weekly and monthly basis respectively, as required by section 64(2)(h) and 98(a) of the MFMA, respectively.
88. The accounting officer of the municipal entity did not take all reasonable steps to ensure that the entity had and maintained a management, accounting and information system which recognised revenue when it is earned, accounting for debtors or account for receipts of revenue, as required by section 97(h) of the MFMA.

Asset management

89. The accounting officers of the parent municipality and municipal entity did not take all reasonable steps to ensure that the parent municipality and municipal entity had and maintained a management, accounting and information system that accounts for the assets of the parent municipality and municipal entity, as required by section 63(2)(a) and 96(2)(a) of the MFMA, respectively.
90. The accounting officers of the parent municipality and municipal entity did not take all reasonable steps to ensure that the parent municipality and municipal entity had and maintained an effective system of internal control for assets (including an asset register), as required by section 63(2)(c) and 96(2)(b) of the MFMA, respectively.

INTERNAL CONTROL

91. In accordance with the PAA and in terms of *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to

my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

92. A lack of management intervention and monitoring measures to ensure that sufficient and timely actions were taken to address previous year qualifications on assets resulted in only certain issues being addressed in the current year. Although a service provider was appointed to conduct a full asset verification, the appointment was made during the latter part of the financial year under review. As a result, phase 1 had not been completed at the date of this report, which resulted in qualification paragraphs on property, plant and equipment.
93. A lack of management intervention and monitoring measures to ensure that sufficient and timely actions were taken to implement actions listed in the audit action plan, resulted in several audit findings again being reported for the current year.
94. The outcome of the municipal elections created uncertainty amongst executive and senior management regarding their current roles and responsibilities. This resulted in a breakdown in the municipality's internal control systems, including the implementation of the audit action plan.
95. Management did not establish adequate control and monitoring measures to ensure that policies and procedures to address weaknesses in the municipality's document management and filing system are addressed.
96. Management did not develop and implement standard operating procedures and processes that detailed how the monitoring of the reported performance information would be conducted, organised and managed, including determining the roles of the different role players.
97. Leadership instability at key management positions in the municipal entity resulted in financial and risk management and internal control responsibilities not being fully achieved. After expiry of his contract, the former chief executive officer of the entity was appointed on a month-to-month basis. His services were terminated in January 2010. The CFO of the entity has also resigned in May 2010. The COO position in the entity has been vacant since April 2011. A process has been started on filling the positions; however, only the CEO position has been filled to date. As a result sufficient actions were not taken timely to address audit findings and to exercise sound corporate governance.
98. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored, which resulted in significant non-compliance matters.

Financial and performance management

99. Due to the lack of management intervention and monitoring measures to ensure that the municipality's filing and accounting systems function effectively as well as a lack of oversight, the finance staff did not compile regular, accurate and complete financial reports. The financial statements were subject to material corrections during the audit process. There was also a lack of knowledge of the GRAP accounting framework within the finance unit.
100. A limitation of scope relating to property, plant and equipment existed due to inadequate document management procedures in the previous year, a lack of capacity and expertise as well as senior management's failure to adequately address the matters previously reported.

101. A process was not adequately implemented to ensure that complete, timely, relevant, accurate and accessible information was available to support information included in the performance report of the municipality.
102. Due to the lack of management intervention and monitoring measures, sufficient and adequate controls were not implemented and monitored to prevent non-compliance with laws and regulations and, in particular, unauthorised, irregular and fruitless and wasteful expenditure.
103. During the period under review the municipal entity had shared the accounting system and bank account with the parent municipality. As a result, several controls over record management resided with the parent municipality. Management's inability to address the fragmented filing of records and documentation between different sections at the municipality resulted in record keeping inefficiencies that hampered the submission of complete, relevant and accurate information to support financial and performance reporting. This resulted in material scope limitations as reported in this report.
104. Due to inefficient internal review processes and the lack of oversight measures by the board and the audit committee of the municipal entity, the financial statements were subject to material corrections resulting from the audit process, which are attributable to the weaknesses in design and implementation of internal control in respect of financial management, response to identified risks and weaknesses in information systems in the entity.

Governance

105. The term of the previous audit committee expired on 31 December 2009. Thereafter, the accounting officers did not prioritise the appointment of an audit committee. A new shared audit committee was only appointed on 17 December 2010. The shared audit committee was therefore not in operation for the full year under review.
106. The executive and general managers did not respond to a number of internal audit reports issued during the year under review. This impacted negatively on the role of internal audit to achieve good governance and accountability.
107. The risk assessment performed during the previous financial year was not updated for the current year. For the period under review, the chief risk officer position was vacant. Management did, as an interim arrangement, not determine clear responsibility with regard to the risk assessment that had to be performed. The internal audit plan was compiled based on the risk assessment of the prior year.

OTHER REPORTS

Investigations

108. During the 2008-09 year, an investigation was conducted by an independent consulting firm at the request of the parent municipality. The investigation was initiated based on the allegation of possible abuse of suspense accounts by employees of the parent municipality and resulted in criminal proceedings being instituted against two employees. The investigation had not been completed at the date of this report and the extent of any permanent losses has not yet been established.
109. During the year under review, an investigation was launched by an independent consulting firm into alleged irregularities in the following directorates of the parent municipality:
 - Fleet and mechanical workshop
 - Revenue and billing
 - Payroll
 - Human resources

- SCM
110. The South African Revenue Service is currently investigating revised VAT returns submitted by the parent municipality. At the date of this report, the investigation was still in progress.
111. A consulting firm was appointed by the municipal entity to conduct an investigation into irregularities relating to the following:
- The financial affairs of the entity
 - Policies and procedures and internal controls
 - The systems and controls at the stores that resulted in theft of materials
 - All issues reported on in the Auditor-General's report
 - Human resource process

The consulting firm was appointed on 22 February 2009 to conduct the investigation referred to above; however, to date the firm has not been able to provide the board and the auditors with the final forensic audit report.

Performance audits

112. A performance audit on the infrastructure delivery process was conducted at the parent municipality as part of a transversal performance audit conducted at various municipalities regarding the infrastructure delivery process. The audit was conducted as the availability of infrastructure is a major contributing factor to securing effective service delivery for the taxpayers of South Africa. After the performance audit at the parent municipality had been finalised, a report with findings was submitted to the parent municipality for comment on 23 December 2009. The parent municipality provided comments on 2 September 2010, indicating that wide-ranging corrective actions would be implemented to address the shortcomings identified. This audit has been concluded and no further reporting is intended. The implementation of the corrective actions will be followed up during the regularity audit.

Pretoria

17 January 2012



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence