

REPORT OF THE AUDITOR-GENERAL TO FREE STATE LEGISLATURE AND THE COUNCIL ON THE METSIMAHOLO LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Metsimaholo Local Municipality set out on pages 6 to 125, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Revenue

6. The municipality did not have an effective system of control for other income and as a result I was unable to obtain sufficient appropriate audit evidence about other income to the amount of R9 874 271 (2011: R9 031 507), as disclosed in note 23 to the financial statements. I was unable to confirm the other income by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for other income.

Provisions

7. The municipality did not provide for the rehabilitation of landfill sites in the current and prior year, as required by section 28(1) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) and in accordance with the SA Standards of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets*. I was unable to quantify the liability as at the end of the current and prior year due to the lack of information to perform the complex calculations involved.

Trade and other payables

8. I was unable to obtain sufficient appropriate audit evidence about trade and other payables of R11 769 951 included in the amount of R114 455 378 (2011: R79 731 446), as disclosed in the statement of financial position and the related detailed disclosure in note 15 to the financial statements. I was unable to confirm the payables by alternative means. Consequently, I was unable to determine whether any adjustments to trade and other payables and accumulated surplus were necessary.

Losses

9. Contrary to the requirements of section 15(2)(d) of the MFMA, the distribution loss from the water and electricity service was not disclosed in the notes to the financial statements. Due to the lack of controls, information and reconciliations to calculate the distribution loss, alternative procedures could not be performed to determine the loss.

Aggregation/ Accumulation of immaterial uncorrected misstatements

10. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements which make up the statement of financial position, the statement of financial performance and the notes to the financial statements:
 - Employee-related costs reflected as R158 465 120 are overstated by R2 823 539.
 - General expenses reflected as R64 040 328 are understated by R1 514 645.
 - Trade and receivables from exchange transactions reflected as R91 023 393 are overstated by R2 866 032.
 - Value Added Tax reflected as understated with R3 440 002.

In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm or verify the following elements by alternative means:

- Service charges reflected as R325 092 050
- Employee-related costs reflected as R158 465 120

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

Qualified opinion

11. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material

respects, the financial position of the Metsimaholo Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matter

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

Going concern

13. The statement of financial performance and the cash flow statement in the annual financial statements indicate that the Metsimaholo Local municipality incurred a net loss of R59 791 930 and a net cash outflow of R27 518 785 during the year ended 30 June 2012. These conditions, along with other matters as set forth in note 44 to the financial statements, indicate the existence of an uncertainty that may cast doubt on the municipality's ability to operate as a going concern.

Irregular expenditure

14. The full extent of the irregular expenditure of R115 633 793, as disclosed in note 47 to the financial statements, is still in the process of being investigated.

Restatement of corresponding figures

15. As disclosed in notes 41 and 42 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of errors discovered during 2011-12 in the financial statements of Metsimaholo Local Municipality at, and for the year ended 30 June 2011.

Additional matter

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

Unaudited supplementary information

17. The supplementary information set out on pages XX to XX 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.

Supplementary explanations of budget variances presented outside the financial statements

18. The supplementary explanations of budget variances contained in actual versus budget, as referred to in notes 51 and 52, do not form part of the financial statements. I have not audited these explanations and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

19. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages X to X of the annual report.
21. The reported performance against predetermined objectives was evaluated against the

overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information*.

The reliability of the information in respect of the selected development objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

22. The material findings are as follows:

Usefulness of information

23. Section 46 of the Municipal Systems Act requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for all the major variances as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve performance.
24. Section 41(c) of the Municipal Systems Act requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 32% of the reported targets are not consistent with the targets as per the approved IDP. This is due to the fact that no process or system was in place to ensure that the objectives, indicators and targets included in the service delivery and budget implementation plan and the performance report are aligned and consistent.

Compliance with laws and regulations

25. I performed procedures to obtain evidence that the entity had complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations, as set out in the *General Notice* issued in terms of the PAA, are as follows:

Budget

26. The accounting officer did not assess the municipality's performance for the first half of the financial year, as required by section 72(1) and 72(1)(a)(ii) of the MFMA.

Procurement and contract management

27. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by supply chain management (SCM) regulation 17(a) and (c).
28. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
29. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
30. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board, in accordance with section 18(1) of the Construction Industry Development Board Act, 2000 (Act No. 38 of 2000).
31. Contracts and quotations were awarded to service providers whose tax matters had

not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

32. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

Expenditure management

33. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
34. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by sections 62(1)(d), 32(4) and 102 of the MFMA.
35. Unauthorised, irregular and fruitless and wasteful expenditure was not investigated and as a result was not recovered from the liable person, as required by section 32(2) of the MFMA.

Annual financial statements, performance and annual reports

36. The annual performance report for the year under review does not include the performance of the external service providers, as required by section 46 (1)(a) of the Municipal Systems Act, 2000 (Act No. 32 of 2000).
37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
38. The 2010-11 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
39. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2010-11 annual report in the council, as required by section 127(3) of the MFMA.
40. The accounting officer did not make the 2010-11 annual report public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
41. The municipal council did not adopt an oversight report containing comments on the annual report within two months from the date on which the 2010-11 annual report was tabled, as required by section 129(1) of the MFMA.
42. The accounting officer did not make public the council's oversight report on the 2010-11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

Asset management

43. The required reports describing the investment portfolio of the municipality were not submitted to the mayor at the end of each month, as required by the municipal investment regulation 9(1).

Internal control

44. I considered internal control relevant to my audit of the financial statements, performance report and compliance with laws and regulations. The matters reported

below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the performance report and the findings on compliance with laws and regulations included in this report.

Leadership

45. The municipality did not ensure that policies and procedures were developed, updated and approved by council as the council did not approve the proposed updates and amendments in the financial year.
46. The occurrence of material irregular expenditure during the year under review indicates that integrity and ethical values were not adequate to prevent irregular expenditure and to set the standard for sound corporate governance as it was not prevented by management.
47. The accounting officer did not take appropriate action to address the lack of discipline in the SCM section, resulting in non-compliance with applicable legislation. This, in turn, resulted in irregular expenditure. This occurred due to a shortage of staff in the SCM unit.

Financial and performance management

48. The staff members of the municipality were not sufficiently skilled to ensure that the daily financial activities are fully and correctly recorded in the records of the municipality. Management also did not ensure that adequate controls were in place to detect and correct all errors in the financial records.
49. The financial statements were subjected to material corrections resulting from the audit process, which are attributable to weaknesses in the design and implementation of internal control in respect of financial management and financial reporting and weaknesses in the information systems of the municipality.
50. The accounting officer did not regularly review and monitor management's compliance with laws, regulations and internally designed policies and procedures. Management did not take action in time to prevent non-compliance issues during the period under review. As a result, significant non-compliance issues were noted that could have been prevented.

Auditor-General

Bloemfontein

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

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