

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Mangaung Metropolitan Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statement of financial performance, statement of changes in net assets, cash flow statement, the statement of comparison of budget and actual amounts 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, 2012 (Act No. 5 of 2012) (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

Cash flow statement

6. I was unable to obtain sufficient appropriate audit evidence regarding the cash flow statement and the related notes for the current and prior years due to the inclusion of transactions that are non-cash in nature, as well as differences between my calculations and the amounts disclosed in the cash flow statement. I was unable to confirm the cash flow statement by alternative means. Consequently, I was unable to determine whether

any adjustment relating to the cash flow statement in the financial statements was necessary.

Budget information

7. The municipality did not disclose the final budgeted and actual figures in the financial statements in accordance with SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements*. The adjustment budget figures for the statement of financial position and the cash flow statement disclosed in the statement of comparison of budget and actual amounts incorrectly included the adjustment budget figures of the municipal entity.. I was not able to determine the full extent of the overstatement of the budgeted figures as it was impracticable to do so. In addition, material differences between the statement of comparison of budget and actual amounts and the cash flow statement were identified for individual line items.

Other receivables from exchange transactions

8. During 2012 I was unable to obtain sufficient appropriate audit evidence for sundry receivables included in other receivables from exchange transactions. I was unable to confirm the sundry receivables by alternative means. Consequently, I was unable to determine whether any adjustments to the sundry receivables stated at R63 128 024 in note 5 to the financial statements were necessary. My audit opinion on the financial statements for the period ended 30 June 2012 was modified accordingly. My opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Accumulation of immaterial uncorrected misstatements

9. The financial statements are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position:
 - Accumulated surplus stated as R9 230 427 061 is understated by R7 540 214
 - Payables from exchange transactions stated as R652 643 630 is understated by R3 254 386.
10. In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm the following elements by alternative means:
 - Un-surveyed land amounting to R40 450 000 included in property, plant and equipment disclosed as R694 662 744 in note 10 to the financial statements.

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 Mangaung Metropolitan Municipality as at 30 June 2013 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 matters

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

Significant uncertainties

13. With reference to note 53 to the financial statements, the municipality is disputing the amounts invoiced by its municipal entity in respect of electricity consumption for public lighting and all municipally owned properties. The ultimate outcome of the matters cannot currently be determined and no provision for any liability that may result has

been made in the financial statements. The possible outflow amounts to R42 931 956 (2012: R14 850 326).

Restatement of corresponding figures

14. As disclosed in notes 56 and 57 to the financial statements, the corresponding figures for 30 June 2012 have been restated as a result of errors discovered during the 2012-13 financial year in the financial statements of the municipality at, and for the year ended, 30 June 2012.

Material losses

15. As disclosed in note 64 to the financial statements, material water losses amounting to R116 966 492 (2012: R111 479 285) were incurred by the municipality mainly due to the deterioration of the water reticulation system and unmetered water connections.

Material impairments

16. As disclosed in note 4 to the financial statements, a provision for debt impairment to the amount of R57 220 684 (99,2%) (2012: R55 507 664) (96,1%) was made with regard to housing selling scheme loans, erven loans, vehicle loans and study loans amounting to R57 715 025 (2012: R57 761 838).
17. As disclosed in note 5 to the financial statements, a provision for debt impairment to the amount of R40 260 398 (40,6%) (2012: R36 937 970) (58,5%) was made with regard to amounts owing to the municipality in respect of sundry receivables, which includes commercial rental income and other miscellaneous services rendered by the municipality amounting to R98 988 936 (2012: R63 128 024).
18. As disclosed in note 6 to the financial statements, a provision for debt impairment to the amount of R322 537 417 (73,9%) (2012: R272 433 076) (71,9%) was made with regard to amounts owing to the municipality in respect of property rates amounting to R436 569 652 (2012: R378 880 397).
19. As disclosed in note 7 to the financial statements, a provision for debt impairment to the amount of R877 904 528 (74,4%) (2012: R697 525 133) (74,6%) was made with regard to amounts owing to the municipality in respect of water and sanitation services, housing rentals rendered by the municipality amounting to R1 179 239 750 (2012: R935 270 754).

Service delivery

20. Included in the cost of buildings as disclosed in note 10 to the financial statements, is a capital spending amount of R351 906 448 that relates to the intermodal public transport facility. The construction of the facility was finalised but to date the facility has not been occupied because of disagreements between the taxi industry and the council.

Additional matter

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

Unaudited supplementary schedules

22. The municipality provided supplementary information in appendix G to the financial statements on whether resources were obtained and used according to the legally adopted budget, in accordance with SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements*. The supplementary budget information set out on pages XX to XX does not form part of the financial statements and are presented as additional information. Accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

23. 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

24. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.

25. 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's *Framework for managing programme performance information* (FMPPI).

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

27. The material findings are as follows:

Usefulness of information

28. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for a total of 59% of the planned targets not achieved were not reflected in the annual performance report. This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

29. Section 41(c) of the MSA requires that the annual performance plan should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of the reported objectives are not consistent with the objectives as per the approved annual performance plan. This is due to the lack of management review to ensure that objectives as per the service delivery and budget implementation plan (SDBIP) and the integrated development plan (IDP) align with objectives disclosed in the annual performance report.

30. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 30% of the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

31. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 32% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

32. The FMPPI requires that indicators/measures should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A

total of 47% of the indicators were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

33. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 30% of the indicators were not verifiable in that valid processes and systems that produce the information on actual performance did not exist. This was due to the fact that management was aware of the requirements of the FMPPI but had not received the necessary training to enable application of the principles.

Reliability of information

34. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
35. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of information presented with respect to the development priority economic development, financial sustainability, spatial development and the built environment, basic services, public transport, social and community services, and good governance.
36. This was due to limitations placed on the scope of my work as the municipality could not provide sufficient appropriate audit evidence in support of the reported performance information.

Additional matter

37. I draw attention to the following matter below. This matter does not have an impact on the audit findings on predetermined objectives reported above.

Material adjustments to the annual performance report

38. Material audit adjustments in the annual performance report were identified during the audit, of which some were corrected by management and those that were not corrected have been reported on accordingly.

Compliance with laws and regulations

39. I performed procedures to obtain evidence that the entity has 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:

Strategic planning and performance management

40. The performance management system of the municipality did not provide for measures to improve performance with regard to those development priorities and objectives where performance targets are not met, as required by section 41(1)(d) of the MSA.
41. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

Budgets

42. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual reports

43. 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, expenditure and disclosure items identified by the auditors were corrected and the supporting records were subsequently provided. The uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements being qualified in this regard.

44. The oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2011-12 annual report was tabled, as required by section 129(1) of the MFMA.
45. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

Audit committees

46. The audit committee did not advise the council on all matters relating to compliance with legislation, as required by section 166(2)(a)(vii) of the MFMA.
47. The audit committee did not review all the quarterly internal audit reports on performance measurement, did not make recommendations to the council on the municipality's performance management system and did not submit, at least twice during the financial year, a report on the review of the performance management system to the council as required by Municipal planning and performance management regulation 14(4)(a).

Expenditure management

48. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Procurement and contract management

49. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by supply chain management (SCM) regulation 43.
50. Sufficient appropriate audit evidence could not be obtained to confirm that the performance of contractors or providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
51. 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).

Conditional grants

52. The municipality did not evaluate its performance in respect of programmes funded by the public transport infrastructure and system grant and the municipal systems improvement grant within two months after the end of the financial year, as required by section 12(5) of the DoRA.
53. The municipality did not submit its signed activity plan for the municipal systems improvement grant to the national department (CoGTA), as required by the Division of Revenue Grant Framework, Gazette No. 35399.

Revenue management

54. An adequate management, accounting and information system which accounts for debtors was not in place, as required by section 64(2)(e) of the MFMA.

Asset management

55. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
56. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequences management

57. Unauthorised expenditure, irregular expenditure as well as fruitless and wasteful expenditure incurred by the municipality was not always investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
58. Unauthorised, irregular, fruitless and wasteful expenditure were not always recovered from the liable person, as required by section 32(2) of the MFMA.
59. The accounting officer did not always report cases of irregular conduct that constituted a crime to the South African Police Service, as required by SCM regulation 28(1)(b).

Internal control

60. I considered internal control relevant to my audit of the financial statements, the annual 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 the qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

61. Due to a lack of basis (benchmark) information for performance reporting and the reconstruction of the performance management system, management did not prioritise and ensure that adequate evidence are kept to support the reported information in the quarterly, mid-year and annual performance reports.
62. Management did not adequately monitor the implementation of prior year audit recommendations to adequately review processes followed in respect of the alignment between the annual performance report and the service delivery budget implementation plan.

Financial and performance management

63. Delays in the re-appointment of consultants who prepared the asset registers and underlying records contributed in the late preparation and submission of the asset registers. This resulted in insufficient time for adequate review processes to be performed by the finance division on the accuracy and completeness of the infrastructure asset registers and the financial statements. This resulted in material adjustments to the financial statements.
64. The asset controllers of the different directorates within the municipality did not on a monthly basis compare the physical assets within their directorates to the asset listings kept at the respective offices. In addition, inadequate communication between the different directorates and the finance division resulted in information in the asset registers relating to the physical location of the assets not being updated on a regular basis.
65. Inadequate communication between the different directorates resulted in incomplete and inaccurate financial reporting relating to future contractual commitments and capital projects in progress. The finance division also did not perform adequate review functions to substantiate the completeness and accuracy of the commitment register. This resulted in material adjustments to the financial statements.

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66. Investigations regarding the recoverability of long outstanding sundry receivables were not concluded before year end, as the data purification exercise on the consumer receivables was prioritised.

Governance

67. Due to the late preparation of the draft financial statements by the finance division, inputs from the internal audit division on the adequacy, reliability and accuracy of the draft financial statements were not obtained prior to the submission thereof to the audit committee. This resulted in insufficient time for adequate review processes to be performed by the audit committee on the fair presentation of the annual financial statements.

68. The implementation of recommendations made by the internal audit division based on findings identified on quarterly and mid-year performance reporting was not adequately monitored by the executive management. This resulted in the report on predetermined objectives being subject to material adjustments.

OTHER REPORTS

Investigations

69. Ten internal investigations relating to alleged theft, financial corruption, fraud, tender irregularities, and non-compliance with municipal SCM regulations by the council employees were finalised during the year. The investigations resulted in the suspension of and criminal proceedings being instituted against municipal officials.

70. Two external investigations relating to alleged theft, financial corruption, fraud, tender irregularities, and non-compliance with municipal SCM regulations were still in progress at year end.

Auditor - General

Bloemfontein

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence