

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE  
COUNCIL OF THE PARENT MUNICIPALITY ON CENTLEC (SOC) LIMITED**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the financial statements of Centlec (SOC) Limited set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets, cash flow statement for the year then ended, statement of comparison of budget and actual amounts, and the notes, comprising a summary of significant accounting policies and other explanatory information.

**Accounting officer 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 Companies Act of South Africa, 2008 (Act No. 71 of 2008) (Companies Act), 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**

### **Property, plant and equipment**

6. The municipal entity did not review the residual values and useful lives of all electricity infrastructure assets at each reporting date in accordance with SA Standard of GRAP, GRAP 17, *Property, plant and equipment*. I was not able to determine the correct net carrying amount of infrastructure assets as it was impracticable to do so. Additionally, there is a consequential impact on the depreciation, surplus for the period and the accumulated surplus. I was also unable to obtain sufficient appropriate audit evidence that management has properly allocated and accounted for sundry expense and labour cost included in infrastructure assets due to the status of the accounting records. I was unable to confirm the infrastructure assets included in property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment to infrastructure assets stated at R1 741 477 303 (2012: R1 686 666 631) in note 8 the financial statements was necessary.

### **Cash and cash equivalents**

7. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for bank balances included in cash and cash equivalents for the current and prior year, as supporting documentation was not attached to cancelled cheques and stopped orders. I was unable to confirm the bank balances by alternative means. Consequently, I was unable to determine whether any adjustment to the bank balances included in cash and cash equivalents stated at R120 391 075 (2012: R162 784 175) in note 3 to the financial statements was necessary.

### **Consumer receivables from exchange transactions**

8. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all consumer receivables from exchange transactions for the current year and prior year, as the vendor account balances and suspense account were not cleared appropriately. Consequently, I was unable to determine whether any adjustment to consumer receivables from exchange transactions stated at R336 070 358 (2012: R291 106 792) in note 5 to the financial statements was necessary.

### **Receivables from exchange transactions**

9. The entity did not account for receivables from exchange transactions in accordance with SA Standard of GRAP, GRAP 104, *Financial instruments*. The entity is party to a number of transactions with its parent municipality which have been accounted for as receivables at a different amount than that disclosed by the parent municipality. Consequently, receivables from exchange transactions and revenue from service charges are overstated by R82 725 035, respectively. Additionally, there is a consequential impact on the surplus for the period and accumulated surplus.

### **Inventory**

10. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all inventory for the current and prior year, as the inventory at one store was not included in the inventory value and adequate supporting documents were not available for the subsequent adjustment made to account for those inventory. I was unable to confirm the value of the inventory by alternative means. Consequently, I was unable to determine

whether any adjustment to inventory stated at R55 146 608 (2012: R39 479 013) in note 4 to the financial statements was necessary.

#### **Payables from exchange transactions**

11. I was unable to obtain sufficient appropriate audit evidence that management has properly accounted for all payables from exchange transactions for the current and prior year due to the status of the accounting records. I was unable to confirm payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustment to payables from exchange transactions stated at R322 435 039 (2012: R415 180 646) in note 15 to the financial statements was necessary.

#### **Revenue from service charges**

12. The entity did not account for revenue from exchange transactions in accordance with SA Standard of GRAP, GRAP 9, *Revenue from exchange transactions* as the consumer estimates for conventional meters were not calculated appropriately. As a result, service charges and consumer receivables from exchange transactions are overstated by R27 674 037 (2012:R56 194 409), respectively. Additionally, I was unable to obtain sufficient appropriate audit evidence for year-end estimates of prepaid sales included in service charges. I was unable to confirm the value of the year-end estimates of prepaid sales by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R1 747 411 671 (2012: R1 549 337 741) in note 21 to the financial statements was necessary.

#### **Statement of comparison of budget and actual amounts**

13. The entity did not disclose the explanations for material differences between the budget amounts and the actual amounts in the financial statements in accordance with SA Standards of GRAP, GRAP 24, *Presentation of budget information in financial statements*. As a result, the budget information disclosed in the financial statements is not complete.

#### **Irregular expenditure**

14. The entity did not disclose all the irregular expenditure in the notes to the financial statements, as required by section 125(2)(d)(i) of the MFMA. The entity made payments in contravention of the supply chain management requirements which were not included in irregular expenditure, resulting in irregular expenditure being understated by R55 953 216 (2012: R37 927 360).

#### **Qualified opinion**

15. 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 Centlec (SOC) Limited as at 30 June 2013 and its financial performance and cash flows for the year then ended in accordance with the SA Standards of GRAP and the requirements of the MFMA and the Companies Act.



### **Emphasis of matters**

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

### **Restatement of corresponding figures**

17. As disclosed in note 41 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 Centlec (SOC) Limited at, and for the year ended, 30 June 2012.

### **Material losses and impairment**

18. As disclosed in note 5 to the financial statements, a provision for debt impairment amounting to R377 628 950 (2012: R341 059 445) has been made with regard to consumer debts with a gross value of R713 699 308 (2012: R632 166 237).
19. As disclosed in note 48 the municipal entity incurred a significant electricity distribution loss of 104 810 908 KWh with a value of R94 906 556 (2012: R183 033 832).

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

20. 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**

21. I performed procedures to obtain evidence about the usefulness and reliability of the information in the service delivery performance report as set out on pages xx to xx of the annual report.
22. 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 priorities. 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* (FMPPPI).
23. 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).

24. The material findings are as follows:

#### **Usefulness of information**

25. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 82% 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 did not receive the necessary training to enable application of the principles.
26. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 77% of the targets. This was due to the fact that management was aware of the requirements of the FMPPI but did not receive the necessary training to enable application of the principles.
27. 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 82% 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 did not receive the necessary training to enable application of the principles.
28. The FMPPI requires that the time period or deadline for delivery be specified. A total of 100% of the targets were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the FMPPI but chose not to prioritise reporting on performance.
29. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 59% 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 did not receive the necessary training to enable application of the principles.

#### **Reliability of information**

30. 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.
31. 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 priorities for electricity and engineering wires. This was due to the fact that the entity could not provide sufficient appropriate evidence in support of the information presented with respect to development priorities for electricity and engineering wires.

## Compliance with laws and regulations

32. 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**


33. The municipal entity did not have and maintain effective, efficient and transparent systems of financial and risk management and internal controls as required by section 95(c)(i) of the MFMA.
34. The accounting officer of the municipal entity did not, by 20 January, assess the performance of the entity during the first half of the financial year, taking into account the targets set in the service delivery agreement, business plan or other agreement with the entity's parent municipality, as required by section 88(1)(a) of the MFMA.

### **Budget**

35. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 87(8) of the MFMA.

### **Annual financial statements, performance and annual reports**

36. 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 cash and cash equivalent, property, plant and equipment, payables, revenue, employee cost, expenditure, related parties, irregular expenditure, and commitments identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
37. The annual report for the year under review does not include an assessment by the accounting officer of any arrears on municipal taxes and service charges, the accounting officer's assessment of the municipal entity performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote and particulars of any corrective action taken or to be taken in response to issues raised in the audit report, as required by sections 121(4)(c), (d), (e) of the MFMA.

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### **Audit committee**

38. The audit committee did not advise the accounting officer and board of directors on matters relating to internal financial control and internal audits, risk management, accounting policies, effective governance, performance management, adequacy, reliability and accuracy of financial reporting and information and performance evaluation as required by section 166(2)(a) of the MFMA.
39. The audit committee did not meet at least four times for the year under review regarding matters related to the entity, as required by section 166(4)(b) of the MFMA.

### **Internal audit**

40. The internal audit unit did not function as required by section 165(2) of the MFMA, as it did not prepare a risk based audit plan and an internal audit programme for the financial year under review as the audit plan was not approved in time.

### **Procurement and contract management**

41. 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 SCM regulation 43.
42. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a).
43. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
44. Awards were made to providers who are in the service of other state institutions or whose directors/ principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulations 44.
45. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) and (c).
46. Sufficient appropriate audit evidence could not be obtained that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of parent municipality, as required by section 116(3) of the MFMA.
47. Sufficient appropriate audit evidence could not be obtained that all extension or modification to contracts were approved by a properly delegated official, as required by SCM regulation 5.
48. The municipal entity did not implement a SCM policy as required by section 111 of the MFMA.

49. Bid adjudication was not always done by committees which were composed in accordance with SCM regulation 29(2).
50. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a) and Preferential Procurement Regulations.
51. Quotations were accepted from prospective providers who are not registered 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).

#### **Human resource management and compensation**

52. The competencies of financial and supply chain management officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels regulation 13.
53. The annual report of the municipal entity did not reflect information on compliance with prescribed minimum competencies as required by the Municipal Regulations on Minimum Competency Levels regulation 14(3).

#### **Expenditure management**

54. Money owing by the municipal entity was not always paid within 30 days, as required by section 99(2) (b) of the MFMA.
55. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred and accounted for creditors, as required by section 99(2) (c) of the MFMA.
56. Reasonable steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 95 (d) of the MFMA.

#### **Revenue management**

57. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 97(h) of the MFMA.
58. An effective system of internal control for debtors and revenue was not in place, as required by section 97(i) of the MFMA.

#### **Asset management**

59. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 96 (2)(a) of the MFMA.
60. An effective system of internal control for assets (including an asset register) was not in place, as required by section 96(2)(b) of the MFMA.





## **Liability management**

61. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 96(2)(a) of the MFMA.
62. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 96(2) (b) of the MFMA.

## **Internal control**

63. I considered internal control relevant to my audit of the financial statements, the service delivery 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 disclaimer of opinion, the findings on the service delivery performance report and the findings on compliance with laws and regulations included in this report.

## **Leadership**

64. Key management positions were vacant during the year under review. The leadership did not always take timely and adequate action to address weaknesses in the finance and supply chain management directorate, which resulted in non-compliance with applicable legislation and gave rise to fruitless and wasteful and irregular expenditure. The lack of decisive action to mitigate emerging risks, implement timely corrective measures and address non-performance was evident by the failure of management to adequately address the external audit findings in a timely manner.

## **Financial and performance management**

65. Effective performance systems, processes and procedures as well as the management thereof had not been adequately developed and implemented. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. This resulted in many findings relating to incorrect recording, classification, non-accrual, disclosure or non-disclosure. Pertinent information is not identified and captured in a form and time frame to support financial reporting.
66. The entity did not manage the payment procedure effectively due to inadequate system controls, resulting in duplicate payments made to suppliers for the same invoices. Furthermore, management could not provide supporting audit evidence for the stopped orders and cancelled cheques.
67. The entity did not correctly implement the policies formulated by management for financial reporting purposes in case of consumption estimates.
68. The evaluation of long outstanding sundry receivables for possible write-off/write back was not concluded before year-end, as the data purification exercise on the consumer receivables was prioritised.
69. The entity did not have the capacity to address backlog issues and financial system problems, resulting in the need to appoint consultants. Consultants assisted also with the preparation of an asset register and financial statements. The management also appointed



consultants to identify the irregular, fruitless and wasteful expenditure.

### **Governance**

70. Internal control deficiencies were not identified, communicated and corrected in a timely manner. This resulted in the prior year audit findings not being substantially addressed. Although the entity had outsourced internal audit function, it was not operating effectively during the year under review. Audit committee did not effectively perform the oversight role over the financial operations of the entity for the entire financial year under review.

*Auditor - General*  
Bloemfontein

10 December 2013



AUDITOR - GENERAL  
SOUTH AFRICA

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