

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the financial statements of the Nketoana Local Municipality set out on pages xx to xx, 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 these 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 audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Nketoana 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 matters

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

Restatement of corresponding figures

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

Material impairments and losses

9. As disclosed in note 6 to the financial statement, a debt impairment provision to the amount of R145 092 481 (2011:R153 446 038) was made for doubtful debts, due to poor collection practices.
10. As disclosed in note 50 to the financial statements, material losses of water and electricity to the amount of R12 607 434 (2011: R21 841 970) were incurred as a result of inadequate controls by management to monitor distribution losses.

Unauthorised expenditure

11. As disclosed in note 46 to the financial statements, unauthorised expenditure to the amount of R21 430 022 (2011:R91 976 261) was incurred, as the municipality had exceeded its total budget for the year ended 30 June 2012.

Irregular expenditure

12. As disclosed in note 48 to the financial statements, irregular expenditure to the amount of R8 627 947 (2011:R8 922 579) was incurred, which was mainly due to non-compliance with the supply chain management requirements in respect of expenditure transactions. The full extent of the irregularities of R8 627 947 is still in the process of being determined.

Additional matter

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

Unaudited supplementary schedules

14. 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

15. 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

16. 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.

17. 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* (FMPPI).

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).

18. The material findings are as follows:

Usefulness of information

Presentation

19. Improvement measures in the annual performance report for a total of 100% of the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act of South Africa, 2000 (Act No.32 of 2000) (MSA). This was due to lack of internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

20. The MSA, section 41(c), 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 100% of the reported objectives, indicators and targets are not consistent with the objectives, indicators and targets as per the approved (IDP). This is due to the lack of internal policies and procedures over the processes pertaining to the reporting of performance information and the use of an incorrect template for reporting.

Reliability of information

Validity, accuracy and completeness

21. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. The institutions could not provide sufficient appropriate evidence to support any of the selected development objectives.

Compliance with laws and regulations

22. 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

23. The municipality did not establish a performance management system and did not clarify the roles and responsibilities of each role player in the functioning of the system. Furthermore, the municipality did not determine the frequency of reporting and the lines of accountability for performance and did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38 (a) of the MSA and Municipal Planning and Performance Management Regulation 7(2)(c),(e), (f) and (g).
24. The municipality did not monitor performance, with regard to each of those development objectives and against the key performance indicators and targets set and did not measure and review performance at least once per year, with regard to each of those development objectives and against the key performance indicators and targets set. Furthermore, the municipality did not take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.

Budgets

25. The accounting officer did not assess the first half of the financial year performance of the municipality, as required by section 72(1) and 72(1)(a)(ii) / 88(1) of the MFMA.

Annual financial statements, performance and annual reports

26. 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 and disclosure items identified by the auditors in the financial statements submitted were subsequently corrected and the supporting records were provided subsequently, resulting in the financial statements receiving an unqualified audit opinion.
27. 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.
28. The accounting officer did not make the 2010-11 annual report public, as required by section 127(5)(a) of the MFMA, because the annual report was not tabled in the council.
29. The annual report for the year under review did not include (i) an assessment by the accounting officer of any arrears on municipal taxes and service charges, (ii) the accounting officer's assessment of the municipality's performance against measurable performance objectives for revenue collection from each revenue source and for each budget vote and (iii) the report of the audit committee as stated by MFMA 121(3)(e)(f)(j) and 121(4)(c)(g).
30. The annual performance report for the year under review does not include the performance of the municipality and names of external service providers, a comparison of the performance with set targets, a comparison with the previous financial year as well as

measures taken to improve performance, as required by section 46(1)(a), (b) and(c) of the MSA.

Audit committees

31. The audit committee did not advise the council on matters relating to risk management, accounting policies, effective governance, performance management and performance evaluation as required by section 166(2)(a) of the MFMA.
32. The audit committee did not respond to the council on the issues raised in the audit reports of the Auditor-General, as required by section 166(2)(c) of the MFMA.
33. A performance audit committee was not in place and the audit committee established in terms of MFMA section 166(1) was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

Internal audit

34. The internal audit unit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).
35. The internal audit unit did not assess the functionality of the performance management system, whether the performance management system complied with the requirements of the MSA and the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b)(i), (ii) and (iii).
36. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager, as required by Municipal Planning and Performance Management Regulation 14(1)(c).

Procurement and contract management

37. 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) & (c).
38. Sufficient appropriate audit evidence could not be obtained that quotations were only awarded to providers whose tax matters have been declared by the South African Revenue Service to be in order as required by SCM regulation 43.
39. 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).

Human resource management and compensation

40. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of MSA.

Expenditure management

41. The accounting officer did not take reasonable steps to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.
42. The accounting officer did not take reasonable steps to prevent irregular expenditure, as required by section 95(d) of the MFMA.
43. Irregular expenditure was not properly investigated and as a result was not recovered from the liable person, as required by section 32(2) of the MFMA.

Revenue management

44. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.

Internal control

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

Leadership

46. Management did not adequately exercise oversight responsibility over compliance with laws and regulations as well as internal control due to the accounting officer not directing and reviewing the performance of the system of internal control and continuously monitor compliance with laws and regulations. It resulted in significant deviations in compliance with applicable laws and regulations and I was not able to confirm the reliability of performance information.
47. Effective human resource management to ensure that adequate and sufficiently skilled resources are in place in the procurement and information technology (IT) section was not implemented. It was mainly due to the fact that the applications for positions advertised did not meet the requirement of skilled and competent candidates.
48. Policies and procedures to enable and support processes with regard to an effective performance management system were not established and implemented as significant findings with regard to performance information were noted. It was due to management not regarding performance information as a main priority.
49. Management did not develop an action plan to address prior year findings in time and therefore it was not fully implemented, resulting in repeat findings with regard to internal control, compliance, information systems, procurement and performance information.

50. Due to a lack of capacity and appropriately skilled IT personnel, management had not enforced proper control over and monitoring of user access control, service provider's activities and IT governance processes.

Financial and performance management

51. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support performance reporting as management did not regard it as a high priority to ensure that formal performance management processes are in place which resulted in material deficiencies in performance information.
52. Regular, accurate and complete financial statements were not prepared by management due to the fact that the financial statements were not properly reviewed, which resulted in material adjustments that were made to the financial statements.
53. Compliance with applicable laws and regulations was not continuously monitored by management, which resulted in significant instances of non-compliance that could have been prevented.

Governance

54. Appropriate risk management activities should ensure that regular risk assessments, including consideration of IT risks, were not conducted because a risk committee was not established and an integrated risk management strategy and risk assessment plan were not compiled.
55. The internal audit division did not audit performance measurements on a continuous basis as the internal audit division did not regard it as a main priority.
56. The audit committee did not provide oversight over the effectiveness of the internal control environment and compliance with laws and regulations as the committee did not respond to the council on any issues raised by the Auditor-General in the audit report and also did not perform the duties of a performance audit committee because the audit committee did not realise the importance of their oversight role in regard of the performance management system, internal control and compliance with laws and regulations.

OTHER REPORTS

Investigations

57. An investigation is being conducted by independent forensic auditors at the request of the bank regarding alleged fraudulent transactions which occurred on 22 and 25 October 2010 from two bank accounts of the municipality. The investigation commenced in the prior financial year. A charge was laid at a police station and suspects were arrested. The money that was defrauded was partially recovered. The amount which was not recovered was R1780 000. Currently, the hacking of the cash focus system is being investigated to determine if the bank can be held responsible for the failure in internal controls. The investigation was still ongoing at the reporting date.

Bloemfontein

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence