

AUDITOR-GENERAL
SOUTH AFRICA

The Municipal Manager
Phumelela Local Municipality
Private Bag X5
Vrede
9835

30 November 2012

Reference: 21392REG11/12

Dear Municipal Manager

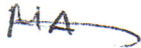
Report of the Auditor-General on the financial statements and other legal and regulatory requirements of the Phumelela Local Municipality for the year ended 30 June 2012

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
3. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
4. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

5. Twenty (20) copies of the municipality's annual report should be submitted to my office once available.
6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely



M. Sesing
Senior Manager

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AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

**Report of the Auditor-General on the
financial statements and other legal and
regulatory requirements of Phumelela
Local Municipality for the year ended
30 June 2012**

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Phumelela local municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statements of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information, and the accounting officer's report.

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 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 conducting the 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. 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. I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of property, plant and equipment with a carrying value of R306 853 660 (2011: R321 503 398) as disclosed in note 5 to the financial statements. The municipality's records did not permit the application of alternative audit procedures due to an incomplete fixed asset register which did not agree to the valuation and the results of the physical verification. Consequently, I was unable to determine whether any adjustments to the property, plant and equipment were necessary.

Investment property

5. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of investment property with a carrying value of R35 691 063 (2011: R35 933 438) as disclosed in note 4 to the financial statements due to inadequate municipal records on accounting for investment property. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to the investment property were necessary.

Impairment loss

6. I was unable to obtain sufficient appropriate audit evidence for the completeness of impairment loss to the amount of R96 170, as disclosed in note 5 to the annual financial statements. I was unable to confirm the impairment loss by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for impairment loss.

Depreciation

7. I was unable to obtain sufficient appropriate audit evidence for the completeness of depreciation and amortisation to the amount of R16 122 002 (2011: R16 441 195), as disclosed in note 5 to the annual financial statements, due to material findings under property, plant and equipment as well as investment property. I was unable to confirm the depreciation by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for depreciation and amortisation.

Accumulated depreciation and impairment

8. I was unable to obtain sufficient appropriate audit evidence for the completeness of depreciation and amortisation to the amount of R16 122 002 (2011: R16 441 195), as disclosed in note 5 to the annual financial statements, due to material findings under property, plant and equipment as well as investment property. I was unable to confirm the depreciation and amortisation by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amounts disclosed for depreciation and amortisation.

Inventory

9. I was unable to obtain sufficient appropriate audit evidence to confirm the completeness and valuation of as well as rights to inventory of R25 910 116 (2011: R25 838 655), as disclosed in note 10 to the financial statements, due to inventory that was physically identified but not included in the annual financial statements. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to the unsold properties held for resale were necessary.

Provisions

10. The valuation and completeness of provisions amounting to R7 600 000 (2011: R6 744 764), as disclosed in note 19 to the financial statements, could not be confirmed due to a lack of supporting documentation. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to determine whether any adjustments to the unsold properties held for resale were necessary.

Accumulated surplus

11. Supporting documentation for adjustments due to changes in accounting policy included in the statement of changes in net assets amounting to R39 194 020 could not be provided for auditing. The valuation and completion of the amount disclosed as accumulated surplus from exchange transactions in the financial statements amounting to R315 415 134 (2011: R345 189 285) could therefore not be confirmed. Based on this difference, the trial balance and general ledger supporting the amount disclosed could not be relied upon and the accumulated surplus as presented in the annual financial

statements is not considered to be fairly valued. I was unable to perform alternative procedures as the primary source of audit evidence could not be provided.

Commitments

12. The municipality did not maintain a project management system for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R40 800 637 (2011: R61 492 075), as stated in note 41 to the financial statements.

Disclaimer of opinion

13. 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 the financial statements.

Emphasis of matters

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

Restatement of corresponding figures

15. As disclosed in note 44 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of reclassification of the amount resulting from the implementation of GRAP 17 and errors identified in the prior year affecting the opening balances in annual financial statements for the year ended 30 June 2011.

Unauthorised expenditure

16. As disclosed in note 47 to the financial statements, the municipality exceeded their budget, resulting in unauthorised expenditure of R20 791 736 mainly as a result of non-cash items (debt impairment and depreciation) that were not adequately budgeted for.

Irregular expenditure

17. The full extent of the irregularities of R110 064 925, as disclosed in note 49 to the financial statements, is still in the process of being investigated.

Additional matter

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

Unaudited supplementary information

19. 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

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 annual 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 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).
23. 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).

The material findings are as follows:

Usefulness of information

Presentation

24. Section 46 of the Municipal Systems Act (MSA) 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 61% of the measures taken to improve performance as disclosed in the annual performance report. This was due to lack of oversight by a designated performance manager and regular review between the planned and reported objectives, indicators and targets. 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 and accuracy of the measures taken to improve performance.

Consistency

25. Section 34(b) of the MSA states that the municipal council may amend its integrated development plan (IDP) in accordance with a prescribed process. Therefore, if the IDP is changed in-year due to significant policy or mandate changes, the updated plan has to be approved by the municipal council according to a prescribed process. A total of 100% of objectives, 100% of indicators and 67% of targets reported in the annual performance report were inconsistent with the objectives, indicators and targets as per the approved IDP. This was due to lack of oversight by a designated performance manager and regular review between the planned and reported objectives, indicators and targets.

Measurability

Performance targets not specific

26. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 74% of the targets relevant to the selected development objectives were not specific in clearly identifying the nature and the required level of performance. This was due to the lack of oversight by a designated performance manager and inadequate involvement by senior manager responsible for the relevant development objectives.

Performance targets not measurable

27. The FMPPI requires that performance targets be measurable. The required performance could not be measured for a total of 89% of the targets relevant to the selected development objectives. This was due to the lack of oversight by a designated performance manager and inadequate involvement by senior manager responsible for the relevant development objectives.

Performance targets not time bound

28. The FMPPI requires that the time period or deadline for delivery be specified. A total of 41% of the targets relevant to the selected development objectives were not time bound in specifying a time period or deadline for delivery. This was due to the lack of oversight by a designated performance manager and inadequate involvement by senior manager responsible for the relevant development objectives.

Performance indicators not well defined

29. 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 63% of the indicators relevant to the selected development objectives were not well defined in that clear and unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the lack of oversight by a designated performance manager and inadequate involvement by senior manager responsible for the relevant development objectives.

Indicators not verifiable

30. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 63% of the indicators relevant to the selected development objectives in that valid processes and systems that produce the information on actual performance did not exist. This was due to the lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information and the lack of oversight by a designated performance manager and inadequate involvement by senior manager responsible for the relevant development objectives.

Reliability of information

Validity, accuracy and completeness

31. 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. Therefore I was unable to obtain sufficient, appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of 100% actual performance reported in the annual performance report. This was due to lack of a document management system, lack of oversight by a designated performance manager and inadequate involvement by the senior manager responsible for the relevant development objective.

Compliance with laws and regulations

32. 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:

Budgets

33. The municipality incurred expenditure in excess of the limits of the amounts provided for in the votes in the approved budget, in contravention of section 15 of the MFMA.
34. Sufficient and appropriate audit evidence could not be obtained that the mayor submitted all quarterly reports to council on the implementation of the budget and the financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
35. Sufficient and appropriate audit evidence could not be obtained that the accounting officer submitted the monthly budget statements to the mayor and/or the relevant provincial treasury, as required by section 71(1) of the MFMA.
36. 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.

Annual financial statements, performance and annual report

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 property, plant and equipment, accumulated surplus, receivables, employee related costs and other disclosure notes identified by the auditors were subsequently corrected, resulting in no material misstatements being reported. The financial statements, however, still received a disclaimer of opinion due to material and pervasive limitation of scope regarding property, plant and equipment and provisions.
38. 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.
39. The annual report does not include an assessment of the accounting officer of any arrears on municipal taxes and service charges.
40. The annual report does not include particulars of any corrective action to be taken in response to issues in the audit report.
41. The annual report does not include the report of the audit committee.

42. The municipality did not prepare a performance report which includes measures taken to improve performance.

Audit committee

43. The audit committee did not advise the accounting officer on matters relating to internal financial control and risk management, as required by section 166(2)(a) of the MFMA.
44. The audit committee did not review the annual financial statements to provide the council with an authoritative and credible view of the financial position of the entity, its efficiency and effectiveness and its overall level of compliance with the MFMA, DoRA and (other applicable legislation), as required by section 166(2)(b) of the MFMA.
45. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.
46. 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.
47. 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

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

Procurement and contract management

49. Contrary to the requirements of section 41(2) of the municipal supply chain (SCM) regulations, I could not obtain a risk register or other documentary proof that risk assessments relating to the SCM system were performed.
50. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by SCM regulation 17(a) and (c).
51. Goods and services were procured from suppliers without a valid tax clearance tax certificate or declaration of interest contrary to the requirements of SCM regulation 13(c).
52. Sufficient appropriate audit evidence could not be obtained that bid specifications for procurement of goods and services through competitive bids were drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as per required by SCM regulation 27(2)(a).
53. Sufficient appropriate audit evidence could not be obtained that bid specifications were drafted by bid specification committees which were composed of one or more officials of the municipality, as required by SCM regulation 27(3).
54. Evaluation and adjudication documentation in respect awarded tenders was not always kept for audit, contrary to the requirements of section 62(1)(c) of the MFMA.

Human resources management and compensation

55. The municipal manager did not ensure that the municipality has adequate human resource capacity that enables it to perform its functions and exercise its powers in an economical, efficient, effective and accountable manner in compliance with section 67 (1)(a) of the MSA.

Expenditure management

56. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
57. The municipality did not recover unauthorised, irregular or fruitless and wasteful expenditure from the liable persons, as required by section 32(2) of the MFMA.

Asset management

58. 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.

Internal control

59. I considered internal control relevant to my audit of the financial statements, 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 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

60. Management did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls due to the accounting officer not directing and reviewing the performance of the system of internal control and continuously monitoring compliance with laws and regulations. This resulted in significant non-compliance with applicable laws and regulations and I was not able to confirm the reliability of performance information.
61. 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. This was mainly due to the fact that the applications for positions advertised did not meet the requirement of skilled and competent candidates.
62. Policies and procedures to enable and support processes with regard to an effective performance management system were not established and implemented as significant findings were raised in relation to performance information. This was due to management not regarding performance information as a main priority.
63. Management developed an action plan to address prior year findings, but did not implement and monitor the plan on a continuous basis, resulting in repeat findings

regarding internal control, compliance, information systems, procurement and performance information.

64. Due to a lack of capacity and appropriately skilled IT personnel, management did not enforce proper monitoring of user access control, service provider activities and IT governance processes.

Financial and performance management

65. Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is not accessible and available to support financial and performance reporting.
66. The staff members of the municipality were not sufficiently skilled to ensure that the daily and monthly financial activities are fully and correctly recorded in the records of the municipality.
67. The financial statements were subject 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 system of the municipality.
68. The accounting officer did not regularly review and monitor management's compliance with applicable laws and regulations and internally designed policies and procedures. As a result, significant non-compliance issues were noted that could have been prevented.

Governance

69. Although the municipality had an internal audit division, it was not adequately resourced and functioning to identify internal control deficiencies and provide recommendations.

Auditor - General

Bloemfontein

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence