

REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE POLOKWANE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Polokwane Local Municipality, 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 flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the 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 (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 identified a significant number of land and buildings that were not included in the financial statements. The municipality did not perform a reconciliation between the financial statements and the underlying accounting records to ensure that land and buildings were completely recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of land and buildings stated at R2 311 446 427 (2011: R2 320 668 202) as stated in note eight to the financial statements.
5. The municipality applied the revaluation model for subsequent measurement of land and buildings. However, the municipality did not assess whether there were any changes in the fair value of buildings which require a further revaluation in accordance with Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*. Consequently, I was unable to determine whether any adjustment relating to land and buildings in the financial statements was necessary.

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6. Included in land and buildings stated at R2 311 446 427, is land valued at R677 770 349 which could not reconcile with the underlying accounting records by R326 255 034. The municipality could not provide any explanations or supporting documentation regarding this difference. Consequently, I am unable to determine whether any further adjustments were necessary to the amount disclosed for land and buildings.
7. The capital under construction of R209 773 409 as disclosed in note eight to the financial statements includes transactions that do not qualify as capital expenditure amounting to R15 416 455. Consequently, the capital under construction of R209 773 409 is overstated by R15 416 455. I am unable to determine the effect on the depreciation and accumulated depreciation that would have been adjusted had the misstatement not occurred.
8. The municipality did not review the useful lives of its buildings stated at R1 633 678 078 at the reporting date as required by the Standards of Generally Recognised Accounting Practice, GRAP 17, *property, plant and equipment*. Consequently, the impact on the carrying value of property, plant and equipment and the corresponding effect on accumulated surplus in accordance with the Standard of Generally Recognised Accounting Practice GRAP 3- *Accounting policies, change in accounting estimates and errors* as disclosed in the statement of financial position could not be determined as it was impractical to do so.
9. The municipality did not review the residual values of its property, plant and equipment, namely buildings and other assets amounting to R5 573 512 985, at each reporting date in accordance with Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment*. I have not determined the correct net carrying amount of infrastructure assets as it was impracticable to do so.
10. The Standard of Generally Recognised Accounting Practice, GRAP 17, *Property, plant and equipment* require that a municipality assess at each reporting date whether there is any indication that an asset may be impaired. No sufficient and appropriate evidence could be provided to confirm that an impairment assessment of the municipality's buildings was performed. Consequently, I was unable to determine whether any adjustment relating to property, plant and equipment of R1 633 676 078 (2011: R1 644 839 035) in the financial statements was necessary.
11. Property, plant and equipment amounting to R43 302 897 could not be verified for existence as the municipality's accounting records did not contain the correct locations and asset descriptions to facilitate such verification. I was unable to confirm the existence of these assets by any alternative means. Consequently I was unable to determine whether any adjustment relating to property, plant and equipment in the financial statements was necessary.

Revenue

12. Included in revenue from service charges of R781 281 433, are consumer accounts that have been incorrectly billed by the municipality which has resulted in under and over billings of R13 169 936 and R53 244 379 respectively. I also identified a further 20 842 consumer accounts on the billing system that did not reconcile to the meter readings as provided by the meter readers for the month of May and June. Management had not quantified the extent of these disagreements with regard to

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the readings. Consequently, I was unable to determine the extent of the adjustments required to be made on revenue from services charges.

13. I identified revenue from service charges relating to pre-paid electricity to the value of R18 422 824 that were not recorded in the financial statements of the municipality. I also identified a further 1 219 consumer accounts that was not recorded in the accounting system and accounted for in the financial statements. Consequently, I am unable to quantify the financial impact on revenue from service charges.
14. The valuation of properties of R45 billion as disclosed in note 17 to the financial statements includes an unexplained difference between the municipal valuation roll and the financial statements amounting to R45 152 569. The municipality did not reconcile the difference of R45 152 569 between the financial statements and the valuation roll. Consequently, I was unable to determine whether any further adjustments to revenue in the financial statements were necessary.

Trade and other receivables from exchange transactions

15. Included in note 12 to the financial statements, is an impairment of consumer debtors amounting to R168 346 946. The municipality did not reconcile a difference of R28 230 697 between the financial statements and accounting records underlying the impairment charge. Consequently, I am unable to satisfy myself as to the correctness of the impairment on the consumer debtors amounting to R168 346 946 as disclosed in note 12 to the financial statements. I could not determine the effect on the other account balances or class of transactions contained in the financial statements.
16. With reference to paragraph 13 and 14 above, I am also unable to satisfy myself on the valuation of trade and other receivables from exchanged transactions as disclosed in note 12 to the financial statements of R263 452 951 (2011: R207 673 599)

Employee cost

17. I have identified a significant amount of payments that were made to individuals who are no longer in the employment of the municipality. Due to the inadequate design of internal controls over the payments to employees, I am unable to quantify the extent of occurrences of such payments and the related impact on the employee cost amounting to R399 033 020 (2011: R362 171 819) as disclosed in note 24 to financial statements.

Expenditure

18. I was unable to obtain sufficient appropriate audit evidence of expenditure transactions amounting to R3 244 944. I was unable to confirm the expenditure by alternative means. Consequently, I was unable to determine whether any adjustments to expenditure and accumulated surplus were necessary.

Cash and cash equivalents

19. Cash and cash equivalents of R10 866 064 as disclosed in note 15 to the financial statements include an unexplained difference of R9 150 492 between the closing and opening cash book balances for the months of May and June. Consequently, I am unable to satisfy myself on the valuation of the cash and cash equivalents as the municipality's records did not permit the application of alternative procedures. I

could not determine the effect on the other account balances or class of transactions contained in the financial statements.

Trade and other payables from exchange transaction

20. Included in note 6 to the financial statements, is staff leave amounting to R43 831 646. I was unable to obtain sufficient and appropriate audit evidence regarding the staff leave balance. No documentation was provided during the audit relating to the staff leave balance. The municipality's records did not permit the application of alternative procedures. Consequently, I am unable to satisfy myself on the valuation of staff leave stated at R43 831 646. (2011: R40 099 206)
21. The municipality could not provide supporting documents for transactions amounting to R13 972 936 included in trade and other payables as disclosed in the annual financial statements at R200 999 279. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that the transactions occurred and whether the transactions were correctly recorded in the accounting records. Consequently, I could not to satisfy myself as to the occurrence and accuracy of transactions amounting to R13 972 936 included in trade and other payables as disclosed in the annual financial statements of R218 419 045 (2011: R180 308 585).

Provisions

22. Included in note 34 to the financial statements, are provisions for post employment health care benefits, long service awards and ex-gratia benefits of R154 437 733, R13 154 854 and R6 807 811 respectively. The assumptions underlying the provisions were not reassessed for valuation in accordance with the International Accounting Standard (IAS) 19 *Employee benefits*. Consequently I was unable to determine whether any adjustment relating to this balance was necessary including the effect on other account balances or classes of transactions in the financial statements.

Valued Added Tax (VAT)

23. The Standard of GRAP 1, Presentation of Financial Statements, requires that expenditure disclosed in the statement of financial performance should exclude payments to be recovered from third parties, such as Value Added Tax. Included in the impairment of the receivables of R35 511 426 (R47 599 029) as disclosed in the financial statements is an impairment charge on the consumer debtors of R22 490 203 (R39 120 623) inclusive of Value Added Tax. Value Added Tax is levied at a zero rate on assessment rates charged to consumers in terms of the Value Added Tax Act, 1991. The municipality has not developed appropriate records to distinguish the consumer debtors by service type that would determine the amount billed for assessment rates. Consequently, I was unable to determine the extent to which Value Added Tax is misstated in the aforementioned impairment charge and the corresponding impact on the Value Added Tax balance of R65 878 887 (R11 599 731) as disclosed in note 14 to the financial statements. The municipality's accounting records did not permit the application of alternative procedures.
24. With reference to the preceding paragraph I am unable to determine the extent to which the VAT is misstated in the prior period balance with regards to the impairment of consumer debtors, as disclosed in note 12 to the financial statements, of R145 856 743. Consequently, the corresponding effect on the accumulated surplus in terms of the Standard of Generally Recognised Accounting Practice,

GRAP 3 – *Accounting policies, changes in accounting estimate and errors* could not be established.

25. Included in the VAT balance of R65 908 014 as disclosed in note 14 to the financial statements, is an adjustment of R41 263 400. The adjustment was as a result of the municipality changing its accounting basis from the invoice to the payment basis. I was unable to obtain sufficient and appropriate evidence regarding the acceptability and completeness of the assumptions used for the adjustment of R41 263 400. The entity's records did not permit the application of alternative procedures and consequently I am unable to determine the valuation of Value Added Tax of R65 908 014.

Prior period errors

26. The municipality did not disclose the prior period errors in accordance with the Standards of Generally Recognised Accounting Practice, GRAP 3, *Accounting policies, changes in accounting estimates and errors* with reference to prior errors disclosed in the statement of net assets. Consequently, I was unable to satisfy myself as to the completeness of the disclosure of the prior period errors amount of R46 884 793 and R423 011 555 made to the accumulated surplus and revaluation reserve respectively as disclosed in the statement of net assets and note 30 to the financial statements.

Irregular expenditure

27. No system was in place for the identification and recognition of irregular expenditure and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all irregular expenditure was properly recorded. Management did not provide evidence that they have identified all the irregular expenditure from the entire expenditure incurred. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure as disclosed in note 34.3 to the financial statements amounting to R204 583 926.

Cash flow statement

28. The Standard of Generally Recognised Accounting Practice, GRAP 2 *Cash flow statements* requires that the municipality summarises the entity's operating, investing and financing activities. I was unable to confirm whether the cash flow statement and the related notes are fairly stated due to the material effect of the scope limitations and identified misstatements as reported in this report.

Disclaimer of opinion

29. 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 these financial statements.

Emphasis of matter

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

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Material losses

30. As disclosed in note 45 to the financial statements, material losses to the amount of R85 746 484 were incurred as a result of losses incurred during the water and electricity distribution process.

Fruitless and wasteful expenditure

31. As disclosed in note 34.2 to the financial statements, the municipality incurred R692 192 as fruitless and wasteful expenditure. The expenditure was as a result of payments made to the previous meter readers during the hand over process with the newly appointed meter readers. A payment for the hand over process was not specified in the contract with the previous meter readers.

Unauthorised expenditure

32. As disclosed in note 34.2 to the financial statements, the municipality incurred R140 440 390 in unauthorised expenditure as expenditure was incurred in excess of the limits of the amounts provided for in the approved budget.

Additional matter

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

Unaudited supplementary schedules

33. 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

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

34. 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.
35. 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 objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information*. The reliability of the information in respect of the selected objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

36. The material findings are as follows:

Usefulness of information

Presentation

Reasons for major variances not explained

37. A total of 33% of major variances between planned and actual achievements were not explained in the annual performance report for the year under review as per the National Treasury annual report preparation guide. This was due to a lack of review and monitoring of the annual performance report by both management and internal audit.

Consistency

Reported targets not consistent between the integrated development plan and the service delivery budget implementation plan (SDBIP)

38. The Municipal Systems Act, section 41(c) requires that the integrated development plan and service delivery and budget implementation plan 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 30% of the reported targets are not consistent with the targets as per the approved integrated development plan and service delivery and budget implementation plan. This is due to the lack of proper planning and provision of training on the principles of performance information planning.

Reliability of information

Validity

Reported performance not valid

39. The National Treasury *Framework for managing programme performance information (FMPPI)* requires that processes and systems which produce the indicator should be verifiable. A total of 46% of the actual reported performance relevant to the Technical services programme differed materially when compared to the evidence provided. This was due to a lack of monitoring and review for the recording of actual achievements by senior management and internal audit.

Accuracy

Reported performance not accurate

40. The National Treasury FMPPI requires that the indicator be accurate enough for its intended use and respond to changes in the level of performance. A total of 46% of the actual reported indicators relevant to Technical Services programme services were not accurate when compared to source information. This was due to a lack of monitoring and review for the recording of actual achievements by senior management and internal audit.

Completeness

Reported performance not complete

41. The National Treasury FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. Source information for 46% of the actual reported performance, for the Technical Services was not completely recorded. This was due to a lack of monitoring and review for the recording of actual achievements by senior management and internal audit.

Compliance with laws and regulations

42. 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

43. The municipality did not afford the local community at least 21 days to comment on the final draft of its integrated development plan before the plan was submitted to council for adoption, as required by regulation 15(3) of the Municipal planning and performance management regulations.
44. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the Municipal Systems Act.

Budgets

45. 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 Municipal Finance Management Act.

Annual financial statements, performance and annual report

46. 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 identified by the auditors were not adequately corrected, which resulted in the financial statements receiving a disclaimer of opinion.

Internal audit

47. The internal audit unit did not audit the performance measurements on a continuous basis and did not submitted quarterly reports on their audits to the municipal manager and the audit committee, as required by Municipal Planning and Performance Management Regulation 14(1) (c).

Procurement and contract management

48. Goods and services with a transaction value of below R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of SCM regulation 17(a) and (c).
49. Invitations for competitive bidding were not always advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).

50. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1) (a).
51. Awards were made to providers whose directors/ principal shareholders are persons in service of the municipality in contravention of SCM regulations 44. Furthermore the providers failed to declare they are in the service of the municipality, as required by SCM regulation 13(c)
52. Awards were made to providers whose directors/ principal shareholders are persons in service of other state institutions, in contravention of SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
53. Irregular expenditure was written off by council before any investigations were conducted by a council committee to determine the recoverability of the irregular expenditure as required by section 32(2) of the MFMA.

Expenditure management

54. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.
55. The accounting officer did not take reasonable steps to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.
56. Fruitless and wasteful expenditure was written off by council before any investigations were conducted by a council committee to determine recoverability of the fruitless and wasteful expenditure as required by section 32(2) of the MFMA

Asset management

57. 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.
58. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2) (c) of the MFMA.

Internal Control

59. 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 basis for disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

60. Oversight responsibility regarding financial and performance reporting, compliance and related internal controls was not exercised properly. The Council did attempt to carry out their oversight responsibility but it was hampered by the lack of credible information provided by management.
61. The current accounting officer was appointed on 1 July 2012 while the previous incumbent had left on 11 May 2012, leaving a leadership vacuum at the critical year-

end period.

62. The critical post of the Chief Financial Officer (CFO) was vacant during the year. The person appointed to act in this capacity did not have the requisite skills and competencies required to manage the finance section of the municipality and to take appropriate related decisions such as the timing of the implementation of the new billing system.
63. The accounting officer did not implement HR management effectively to ensure that adequate and sufficiently skilled resources are in place.

Financial and performance management

64. The acting CFO was not able to ensure the compilation of credible and reliable financial statements for the financial year under review.
65. The financial statements and other information to be included in the annual report were not reviewed for accuracy and completeness by the accounting officer.
66. Controls over daily and monthly processing and reconciling of transactions were not implemented by the accounting officer.
67. Compliance with laws and regulations was not reviewed and monitored by the accounting officer.
68. The process of implementing a new billing system towards the end of the financial year were not well considered and managed to ensure that customer accounts were accurate and complete.

Governance

69. The risk assessment procedures implemented by the municipality were not adequate, as all risks affecting the municipality were not identified.
70. The internal audit function did not effectively conduct internal reviews of performance management systems and as a result did not cover compliance aspects as well as the usefulness and reliability of reported performance information.
71. Management did not effectively follow up the implementation of internal and external audit recommendations to address the audit outcomes.

OTHER REPORTS

Investigations

72. An investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on the allegation of possible irregular payments of overtime, payments of leave encashment and on the financial misconduct on the then chief financial officer. The investigation resulted in the dismissal of the chief financial officer. Proceedings on other employees were still in progress at the reporting date.

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73. An investigation is being conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on the allegation of possible supply chain management irregularities and the possibility of payments to ghost employees. The investigation was still ongoing at the reporting date.

T. Auditor - General

Polokwane
30 November 2012



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