

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I was engaged to audit the financial statements of the Modimolle 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, 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

#### Accumulation of material uncorrected misstatements

4. The comparative figures as disclosed in the note 4 to the financial statements include the following unexplained differences between the prior year audited financial statements and the current year restated amounts:

- Inventory to the amount of R837 720
- Property, plant and equipment to the amount of R3 053 607
- Trade and other receivables to the amount of R4 450 706
- Expenditure to the amount of R1 410 510
- Employee cost to the amount of R769 317

The municipality's records did not permit the application of alternative procedures regarding these differences. Consequently, I was unable to determine whether any adjustments to the comparative figures were necessary.

### **Inventory**

5. A difference of R1 764 669 was noted between the inventory balance of R6 512 166 disclosed in note 4 to the financial statements and the underlying accounting records. The municipality did perform reconciliation between the financial statements and the inventory valuation report. Consequently, inventory is overstated and expenses understated by R1 764 669

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

6. The municipality could not provide us with supporting documentation for the valuation of its unbundled assets to the amount of R609 312 040 as disclosed in note 8 to the financial statements. Consequently, I was unable to determine whether any adjustments to the property, plant and equipment figure were necessary.
7. I was unable to reconcile the properties of the municipality amounting to R793 966 471 as disclosed in note 8 to the financial statements to the title deeds of the municipality due to inadequate descriptions and references being used. The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the property, plant and equipment figure were necessary.
8. An unexplained difference of R2 319 430 was noted between the total amount for property, plant and equipment amounting to R806 667 394 as disclosed in note 8 to the financial statements and underlying accounting records. The municipality's accounting records did not permit the application of alternative procedures. Consequently, I was unable to determine whether any adjustments to the property, plant and equipment figure were necessary.
9. Assets to the value of R1 143 160 could not be traced to the accounting records and financial statements. As a result of the matter reported on in the preceding paragraph I was unable to determine the effect on property, plant and equipment stated at R806 667 394 in the financial statements.
10. The municipality could not provide me with supporting documentation for journal entries to the amount of R12 131 824. The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the property, plant and equipment figure were necessary.

### **Trade and other payables**

11. Included in trade and other payables is a journal entry amounting to R5 009 243 for which no sufficient appropriate audit evidence could be provided. I was unable to confirm this journal entry by alternative means. Consequently I was unable to determine whether any adjustments to the accounts payable figure were necessary.

### **Trade and other receivables**

12. The International Financial Reporting Standard, IFRS 7. *Financial Instruments. Disclosures*, requires the municipality to develop an accounting policy which highlights the methods and assumptions used to determine the fair value of each class of financial assets or financial liabilities. In contravention with IFRS 7, the municipality has not developed accounting

policies, methods and assumptions for the calculation of the trade receivable impairment provision amounting to R23 229 062 as disclosed in note 2 to the financial statements. Consequently I was unable to determine whether any adjustment relating to the impairment provision was necessary.

13. The International Financial Reporting Standard, IFRS 7, *Financial Instruments: Disclosures*, requires the municipality to disclose an analysis of the age of the financial assets that are past due as at the end of the reporting period but not impaired, and an analysis of financial assets that are individually determined to be impaired, including the factors the entity considered in determining that they are impaired. No disclosures in the financial statements were made in accordance with the requirements of the above standard has not disclosed an analysis of the age of its financial assets in terms of the above requirements.

#### **Cash and cash equivalents**

14. The municipality could not provide me with supporting documentation for a difference identified between the figure for cash and cash equivalents and the bank confirmation received amounting to R4 036 061. Furthermore due to the lack of bank reconciliation performed by the municipality I was unable to validate the reconciling amounts making up this difference. The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the cash and cash equivalent figure of R55 498 861 disclosed in note 1 to the financial statements were necessary.

#### **Value Added Tax (VAT)**

15. The municipality was unable to provide me with documentation supporting journals to the amount of R5 278 632 that were processed against the VAT payable balance of R15 766 179 as disclosed in note 14 to the financial statements. Furthermore, the municipality could not provide me with supporting documentation for a difference identified between the general ledger and the VAT 201 returns amounting to R18 933 123. The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the VAT figure were necessary.

#### **Irregular expenditure**

16. The municipality procured goods and services amounting to R1 206 107 in contravention of the supply chain management requirements. The amount was not included in note 37.3 to the financial statements as required by section 125(2)(d) of the MFMA. Furthermore, due to the inadequate implementation of an appropriate procurement and provisioning system, I was unable to obtain sufficient appropriate evidence that the irregular expenditure identified above and the amount disclosed in note 37.3 to the financial statements of R 5 551 832 represents all the irregular expenditure incurred during the financial year under review.

#### **Expenditure**

17. I was unable to obtain sufficient appropriate audit evidence for differences identified between the annual financial statements and supporting documentation to the amount of R14 227 904. Furthermore, I was unable to obtain sufficient appropriate audit evidence for expenditure to the amount of R2 195 188 (2011: R 662 443). The municipality's records did not permit the application of alternative procedures regarding this amount. Consequently, I was unable to determine whether any adjustments to the expenditure figure were necessary.

## Revenue

18. There was no system of control over the recognition and recording of prepaid electricity revenue on which I could rely for the purpose of my audit, and there were no satisfactory audit procedures that I could perform to obtain reasonable assurance that all prepaid electricity revenue was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness and accuracy of prepaid electricity revenue of R20 434 194 (2011: R16 542 895)
19. The municipality did not use National Energy Regulator of South Africa's (NERSA) approved tariffs to bill consumers for electricity consumption. I have recalculated the revenue (service charges: electricity) and noted a difference of R7 070 236. Revenue to the amount of R96 376 088 as disclosed in note 21 to the financial statements is overstated by R7 070 236 and payables are understated with the same amount.

## Disclaimer of opinion

20. 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 matter

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

## Unauthorised and fruitless and wasteful expenditure

21. As disclosed in note 37.1 to the financial statements, the municipality incurred unauthorised expenditure of R16 369 651 as a result of expenditure in excess of the limits of the amounts provided for in the votes of the approved budget.
22. As disclosed in note 37.2 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R557 325 as a result of interest and penalties paid due to late payments to suppliers and overpayment of payroll related expenditure.

## Material losses

23. As disclosed in note 2 to the financial statements, the municipality incurred material losses to the amount of R3 390 808 as a result of the write-off of irrecoverable trade receivables.

## Restatement of corresponding figures

24. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered in the 2012 financial statements of the Modimolle Local Municipality at, and for the year ended, 30 June 2011.

## Additional matter

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

## Unaudited supplementary schedules

25. 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

26. 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

27. 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.
28. 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*.
29. 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)

### Usefulness of information

#### Presentation

30. The annual performance report of the municipality did not reflect the comparison of the actual performances of the municipality and its service providers with the current years' targets and its prior year performances.
31. Section 46 of the Municipal Systems Act requires the municipality to disclose the measures taken to improve its performance in the annual performance report where the planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 100% of the measures taken to improve its performance as disclosed in the annual performance report. The municipality's records did not permit the application of alternative audit procedures due to the limitations placed on the scope of my work. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the validity, accuracy and completeness of the measures taken to improve its performance.

#### Consistency

32. The Municipal Systems Act, section 41(c) requires that the integrated development 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 25% of the reported objectives of the Municipality are not consistent with the objectives as per the approved integrated development plan. This is the result of the annual performance report not being properly reviewed by management.

#### Measurability

33. The *National Treasury Framework for managing programme performance information (FMPPi)* requires that performance targets should be measurable. The required

performance of the Municipality could not be measured for a total of 60% of its service delivery targets. This was due to the fact that management was not aware of the requirements of the National Treasury *FMPPI*.

34. The National Treasury *FMPPI* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 60% of the targets relevant to basic service delivery were not verifiable 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. There is also the lack of the necessary skills required to run the process collection, collation, verification and storage of the actual performance information.

### **Reliability of information**

#### **Validity**

35. The National Treasury *FMPPI* requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 67% of basic service delivery programme. This was due to limitations placed on the scope of my work due to the absence of information systems and the institution's records not permitting the application of alternative audit procedures.

#### **Accuracy**

36. A total of 13% of the actual reported indicators relevant to the basic service delivery programme were not accurately reported compared to the source information provided for audit purposes. This was due to a lack of monitoring, review and standard operating procedures for the recording of actual achievements.

#### **Completeness**

37. The National Treasury *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 predetermined objectives.

#### **Additional matter**

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

#### **Achievement of planned targets**

38. Of the total number of 200 planned targets, only 71 targets were achieved during the year under review. This represents 64% of total planned targets that were not achieved during the year under review. This was mainly due to the fact that indicators and targets were not suitably developed during the strategic planning process.

#### **Compliance with laws and regulations**

39. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

## **Budgets**

40. The municipality incurred expenditure that was not budgeted for and 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.

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

41. 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.
42. 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.
43. A written explanation was not submitted to council setting out the reasons for the delay for the tabling of the 2010-11 annual report in the council, as required by section 127(3) of the MFMA.

## **Audit committee**

44. I have not obtained audit evidence that the audit committee has reviewed the quarterly internal audit reports on performance measurement, as required by Municipal Planning and Performance Regulation 14(4)(a)(i).
45. The audit committee did not review the municipality's performance management system and make recommendations to the council, as required by Municipal Planning and Performance Management Regulation 14(4) (a) (ii).
46. The audit committee did not submit at least twice during the financial year, an audit report on the review of the performance management system to the council, as required by Municipal Planning and Performance Management Regulation 14(4) (a) (iii).

## **Internal audit**

47. The internal audit 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).
48. The internal audit unit did not access the functionality of the performance management system as required by the Municipal Planning and Performance Management Regulation 14(1)(b)
49. The internal audit unit did not audit the performance measurement on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee as required by the Municipal Planning and Performance Management Regulation 14(1)(c).

## **Procurement and contract management**

50. 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).

51. Sufficient appropriate audit evidence could not be obtained that all contracts were only awarded to providers who's tax matters have been declared by the South African Revenue Services to be in order as required by SCM regulation 43.

#### **Expenditure management**

52. 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.
53. 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.
54. We were unable to obtain audit evidence to confirm that unauthorised, irregular and fruitless and wasteful expenditure was recovered from the liable person, as required by section 32(2) of the MFMA.

#### **Revenue management**

55. A credit control and debt collection policy was not implemented as required by section 93(b) of the Municipal Systems Act, and section 62(1)(f)(iii) of the MFMA.
56. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.
57. An adequate management, accounting and information system was not in place which recognised revenue when it was earned, as required by section 64(2)(e) 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.
59. An effective system of internal control for assets was not in place as required by section 63(2)(c) of the MFMA.

#### **Internal Control**

60. 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**

61. Management does not always appropriately provide the required supervision and review over the operations of the municipality to ensure that it complies with all laws and regulations and appoint the necessary skilled staff members. Action plans were developed but not fully implemented, hence the recurrence of findings identified in the prior year with regard to asset, cash and revenue management.

#### **Financial and performance management**

62. A lack of adequate technical knowledge within management, a high level of reliance on consultants with regard to the preparation of financial statements and a lack of adherence to laws and regulations resulted in the disclaimer of opinion on the financial statements.

63. A lack of technical knowledge in the finance section with regard to new accounting standards and legislation applicable to the municipality to adequately perform their functions relating to regular reconciliations, adherence to laws and regulations and reporting against predetermined objectives.

64. There is no monitoring of, and controls within the performance management process to ensure performance against predetermined objectives are useful and reliable

#### Governance

65. Management's ineffectiveness with the implementation of recommendations from internal and external audit prevented the audit committee from promoting accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations.

Auditor General

Polokwane

30 November 2012

