



REPORT OF THE AUDITOR-GENERAL TO THE NORTH WEST PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE LEKWA TEEMANE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Lekwa Teemane Local Municipality, which comprise the statement of financial position as at 30 June 2012, and the statement 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 South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 5 of 2012) (DoRA) and for such internal control as management determines is necessary to enable the preparation of the 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

Disclaimer of opinion

Property, plant and equipment

4. I was unable to obtain sufficient appropriate audit evidence for property, plant and equipment of R872 726 167 (2011: R844 457 015) disclosed in note 3 to the financial statements. The municipality's system did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, valuation and allocation, existence, rights and obligation and the presentation and disclosure of property, plant and equipment.

Consumer debtors

5. I was unable to obtain sufficient appropriate audit evidence to determine the completeness, valuation and allocation, rights and obligations and existence of consumer debtors from exchange transactions. The municipality's system did not allow the performance of alternative procedures. Consequently, I was unable to determine whether any adjustments to the

consumer debtors of R40 790 588 (2011: R9 337 483) disclosed in note 11 to the financial statements were necessary.

6. SA Standard of GRAP, IAS 39, *Financial Instruments: Recognition and Measurement*, paragraph 58 requires that an entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. The municipality did not assess consumer debtors, individually or by category, for any indication that these assets may be impaired. The municipality's system did not allow the performance of alternative audit procedures to practicably determine the extent of the misstatement in debtors and the impairment expense. Consequently I am unable to satisfy myself as to the valuation and allocation of consumer debtors of R40 790 588 (2011: R9 337 483) as disclosed in note 11 to the financial statements.

Accumulated surplus

7. I was unable to obtain sufficient appropriate audit evidence to determine the existence, rights, completeness, valuation and allocation and compliance of accumulated surplus. The municipality's system did not allow the performance of alternative procedures. Consequently I was unable to determine whether any adjustments to the accumulated surplus of R670 798 380 (2011: R718 945 371) as disclosed in the statement of changes in net assets were necessary.

Provisions

8. The SA Standard of GRAP, GRAP 19, *Provisions, contingent liabilities and contingent assets* require that provisions be recognised when an entity has a present obligation that will result in an outflow of economic resources that can be reliably estimated. I was unable to obtain sufficient appropriate audit evidence for a provision for the completeness of the restoration of the landfill sites of R240 000 (2011: R240 000) as disclosed in note 19 to the financial statements. The municipality's system did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness, existence, valuation and allocation, obligation and compliance of this provision. I was unable to determine the effect of this limitation on the other account balances and classes of transactions contained in the financial statements.
9. Provisions is overstated by R5 228 680 (2011: R2 906 214) as the leave pay accrual is incorrectly recognised as a provision instead of an accrual in accordance with paragraph 10 of the International Accounting Standards, IAS 19, *Employee Benefits*. As a result trade and other payables from exchange transactions is understated by the same amounts.

Trade and other payables

10. I was unable to obtain sufficient appropriate audit evidence to determine the completeness, valuation and allocation, obligations and existence of trade and other payables from exchange transactions. The municipality's system did not allow the performance of alternative procedures. Consequently, I was unable to determine whether any adjustments to trade and other payables of R136 016 286 (2011: R108 093 273) disclosed in note 20 to the financial statements were necessary.

Correction of prior year errors, change in accounting estimates and change in accounting policies

11. I was unable to obtain sufficient appropriate audit evidence to determine that all requirements of SA Standards of GRAP, GRAP 3, *Accounting policies, changes in accounting estimates and errors* were adhered as disclosed in note 42 to the financial statements. The municipality's system did not allow the performance of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the



presentation and disclosure of the prior year errors, change in accounting estimates and change in accounting policies.

Cash flow statement

12. Taking into account the misstatements identified in the financial statements and set out in this report, I was unable to practicably quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine the accuracy, completeness and presentation and disclosure of the cash flow statement and notes thereto.

GRAP disclosures

13. The municipality did not disclose in the financial statements new SA Standards of GRAP that have been issued, that are not yet effective and that were not applied as required by SA Standards of GRAP, GRAP 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. This fact and the known or reasonably estimable information relevant to assessing the possible impact that application of the new standard will have on the entity's financial statements in the period of initial application, was not disclosed in the financial statements.

Unauthorised, irregular and fruitless and wasteful expenditure

14. I was unable to obtain sufficient appropriate audit evidence for unauthorised expenditure of R61 310 566 (2011: R27 271 760) and fruitless and wasteful expenditure of R4 282 084 (2011:R0) disclosed in notes 47 and 48 to the financial statements respectively. The municipality's system did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, occurrence, accuracy and valuation, classification and understandability and compliance of unauthorised and fruitless and wasteful expenditure.
15. Section 125(2)(d)(ii) of the MFMA requires disclosure of all material irregular expenditure. I was unable to obtain sufficient appropriate audit evidence for awards of R9 670 777 and capital expenditure of R18 732 150 made in terms of the municipality's supply chain management policy. In addition, during 2011 the municipality made payments of R3 771 965 in contravention of the supply chain management requirements. The municipality's system did not permit the application of alternative procedures. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself that all material irregular expenditure has been disclosed in the notes to the financial statements.

Disclaimer of opinion

16. 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 matters

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

Restatement of corresponding figures

18. As disclosed in note 42 to the financial statements, the corresponding figures for investment property, property plant and equipment, intangible assets, provisions, government grant reserves and accumulated surplus have been restated as a result of errors discovered during the 2012 year in the financial statements at, and for the year ended 30 June 2011.

Material under spending of conditional grants

19. As disclosed in note 18 to the financial statements, the municipality has materially under spent on conditional grants to the amount of R7 698 355 (2011: R5 337 483). The material under



spending occurred mainly on the Municipal Infrastructure Grant, which is the national grant for various projects.

Material losses and impairments

20. As disclosed in note 11 to the financial statements, material losses of R12 183 378 (2011: R78 592 846) were incurred as a result of significant impairments of receivables.
21. As disclosed in note 50 to the financial statements, the municipality incurred electricity distribution losses of R11 268 837 (2011: R9 007 845).

Going concern

22. The accounting officer's report indicates the Lekwa Teemane Local Municipality incurred a net loss of R25 752 017 (2011: R98 285 276) during the year ended 30 June 2011 and, as of that date, the entity's current liabilities exceeded its total current assets by R128 898 491 (2011: R115 035 212). These conditions, along with other matters as set forth in note 45, indicate the existence of a material uncertainty that may cast significant doubt on the entity's ability to operate as a going concern.

Additional matters

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

Unaudited supplementary schedules

24. The municipality provided supplementary information in the financial statements. The supplementary information set out on pages [XX] to [XX] does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Withdrawal from the audit engagement

25. Due to the limitation imposed on the scope of the audit by management, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of municipalities, I would have withdrawn from the engagement in terms of the ISAs.

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/ development priorities or 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).
29. The reliability of the information in respect of the selected programmes/ objectives/ development priorities or objectives is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).



30. The material findings are as follows:

Usefulness of information

31. Section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2008) (MSA) requires the disclosure of measures taken to improve performance in the annual performance report where planned targets were not achieved. For a total of 21% of the planned targets not achieved no measures taken to improve performance were disclosed. In addition, adequate and reliable corroborating evidence could not be provided for 43% of the measures taken to improve performance that were disclosed in the annual performance report. The portfolio of evidence 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, accuracy and completeness of the measures taken to improve performance.
32. The National Treasury FMPPI requires that the time period or deadline for delivery be specified. A total of 20% of the targets relevant to material development programmes / objectives were not time bound in specifying a time period or deadline for delivery. This was due to lack of oversight responsibility by management to ensure that performance objectives are set to be measurable and achievable within specified time frames.

Reliability of information

33. The National Treasury FMPPI requires that processes and systems which produce the indicator should be verifiable. A total of 30% of the actual reported indicators/measures relevant to the "to deliver sustainable essential services such as water, sanitation, waste management, electricity and roads/storm water for the Lekwa-Teemane communities at least at RDP level" objective was not valid or differed materially when compared to the source information and/or evidence provided. 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. This was due to limitations placed on the scope of my work due to the institution's records not permitting the application of alternative audit procedures.
34. 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 30% of the actual reported indicators/measures relevant to the "improve the quantity and quality of basic services for all people in terms of water, sanitation, electricity, waste management, roads and disaster management" objective were not accurate when compared to source information. This was due to a lack of monitoring and review of standard operating procedures for the recording of actual achievements by senior management and internal audit.
35. 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 31% of the actual reported indicators/measures relevant to the "social economic development" objective were not accurate when compared to source information. This was due to a lack of monitoring and review of standard operating procedures for the recording of actual achievements by senior management and internal audit.

Additional matter

36. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

Achievement of planned targets

37. Of the total number of planned targets, only 29 targets were achieved during the year under review. This represents 37% 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

38. 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

39. The accounting officer of the municipality did not by 25 January 2012 assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan as required by section 72(1)(a)(ii) of the MFMA.
40. The municipality did not adopt and implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players as required by section 38, 39, 40 and 41 of the MSA read with regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

Annual Financial Statements 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 corrected and and/or the supporting records could not be provided subsequently, the uncorrected material misstatements resulted in the financial statements receiving a disclaimer audit opinion.
42. The mayor did not table, in council, the 2010/11 annual report of the municipality, within seven months after the end of the financial year as required by section 127(2) of the MFMA.
43. The council of the municipality did not adopt oversight reports on the annual report within two months of the tabling of the annual report as required by section 129(1) of the MFMA.

Procurement and contract management

44. Goods and services with a transaction value of between R10 000 and 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).
45. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids as per the requirements of SCM regulation 19(a).
46. The preferential 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).
47. The performance of contractors or providers was not monitored on a monthly basis as required by section 116(2)(b) of the MFMA.

Human resource management and compensation

48. The competencies of financial and supply chain management officials were not assessed promptly in order to identify and address gaps in competency levels as required by the Municipal Regulations on Minimum Competency Levels regulation 13.

Revenue management

49. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for revenue as required by section 64 of the MFMA

Expenditure management

50. 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.

Asset management

51. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets as required by section 63(2)(c) of the MFMA.

Waste management

52. The municipality operated their waste disposal site(s) without a waste management license or permit, in contravention with the requirements of section 20(b) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 20(1) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989), or section 22 of the National Water Act (36 of 1998) (NWA).
53. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the National Environmental Management Act, 1998 (Act No. 107 of 1998), Section 19 of the NWA, and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

Internal control

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

Leadership

55. Management failed to timely appoint sufficient appropriately skilled staff in key positions within the finance unit and the training and development initiatives failed to address the underlying deficiencies that caused matters to be repeatedly reported on in the audit report. Policies and procedures did not adequately guide financial and performance activities. Action plans designed to address prior year audit findings as discussed and agreed with municipal public accounts committee and council were not implemented and reflects negatively on management's ability to address recurring audit findings.
56. Council did not effectively execute its oversight responsibility concerning the establishment and communication of policies and procedures to enable and support the understanding and execution of internal control objectives, processes, and responsibilities in terms of financial reporting and compliance with laws and regulations.
57. On-going monitoring and supervision undertaken to enable management to determine whether internal controls over financial and performance reporting are present and functioning was not adequate leading to material misstatements to the financial statements and non-compliance with laws and regulations.

Financial and performance management

58. Management failed to implement effective controls to ensure that information in the financial statements and the report on predetermined objectives were reliable before submission for audit. This was mainly due to the inability of management to address the prior years' audit findings and staff in the finance section not understanding the requirements of the financial reporting framework. The ignorance of management to address the repetitive findings relating to supply chain management regulations is indicative of financial misconduct.



59. The accounting officer does not exercise effective oversight over reporting and compliance with laws and regulations and internal control.
60. Controls are not adequately monitored to ensure that information in the financial statements is reliable. This includes key reconciliations to ensure that all disclosures made are supported by reliable information.
61. The finance, supply chain management and human resources departments are understaffed which resulted in material misstatements to the financial statements submitted for audit and the non-compliance to supply chain management regulations.
62. Internal controls to monitor compliance with laws and regulations have not been effectively applied resulting in significant non-compliance with legislation including instances of irregular and fruitless and wasteful expenditure.
63. The accounting officer does not have an adequate support structure as not all section 57 manager positions were filled at the municipality.

Governance

64. The risks identified during the risk assessment process relating to financial and performance reporting and compliance with laws and regulations were not adequately addressed in the risk management strategy adopted by the municipality. Though the audit committee fulfilled its function, the municipality did not adequately respond to the concerns raised by the audit committee, resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective.
65. The council failed to implement good governance principles within the municipality as the risk assessment was not performed and the internal audit unit and audit committee was not effective.
66. Based on the number of repeat findings in the current year and lack of implementation of the audit action plan, the governance structures and management did not appropriately address identified internal control deficiencies and non-compliance with laws and regulations.
67. Though the audit committee fulfilled its function, the entity did not adequately respond to the concerns raised by the audit committee, resulting in the internal control environment over financial and performance information and compliance with laws and regulations being ineffective.

Auditor General

Potchefstroom

30 November 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

