

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

REPORT ON THE ANNUAL FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Nketoana Local Municipality which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory information, as set out on pages ... to

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 in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No.56 of 2003) (MFMA). This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126 of the MFMA, my responsibility is to express an opinion on the financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Revenue

7. There was no system of control over prepaid electricity 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 prepaid electricity was accurately recorded using the tariffs approved by the National Energy Regulator of South Africa (NERSA). Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the accuracy and completeness of revenue from the sale of prepaid electricity of R588 066 disclosed under note 14 to the financial statements.

Accumulated surplus

8. In paragraph 13 of the prior year's audit report, I reported that differences were identified between

the interest rate charged as per the system and the rates that should have been charged. As the relevant information was not available I was not able to calculate what the interest charged against trade and other receivables and interest earned revenue should have been had the rates been applied correctly.

This error was corrected in the 2009-10 financial year but it was not done so retrospectively. As a result, the opening balances for trade and other receivables and the accumulated surplus were misstated by R364 112. The current year's interest revenue was also misstated by the same amount.

9. The following matters reported in paragraph 13 of the prior year audit report have not been resolved. As a result, the corresponding figures of the current year trade receivables as disclosed in note 2 and accumulated surplus are misstated by an unquantified amount:
- a) Differences were identified with regard to meter readings and tariffs used to levy charges during the year. As the relevant information was not available I was not able to calculate what the charges against trade and other receivables and service charges revenue should have been had the tariffs been applied correctly.
 - b) Differences were identified between the electricity tariffs charged and the approved tariffs as per NERSA. As the relevant information was not available I was not able to calculate what the electricity tariffs charged against trade and other receivables and service charges revenue should have been had the tariffs been applied correctly.
 - c) Sufficient supporting documentation could not be obtained for a journal amounting to R6 611 934 that was posted to the other income revenue general ledger account and journals amounting to R37 495 123 and R37 536 516 debited and credited against revenue respectively.

Property, plant and equipment (PPE)

10. Fixed assets could not be physically identified for inspection due to a lack of the proper and unique identification of the assets and their location in the fixed asset register. No alternative procedures could be performed as the fixed asset register was deemed the only suitable record of fixed assets held by the municipality. Therefore, I could not obtain sufficient appropriate audit evidence to confirm the existence and completeness of the municipality's property, plant and equipment at year-end amounting to R1 070 238 522 (2009: R1 039 224 070) (provisional value as per Directive 4) as disclosed in the statement of financial position and note 6 to the financial statements.

Irregular expenditure

11. Irregular expenditure amounting to R1 902 222 (2009: R6 215 356) which resulted from non-compliance with the municipality's supply chain management policy were identified. This irregular expenditure is not disclosed as required by section 125(2)(d) of the MFMA and therefore irregular expenditure as disclosed in the note 30.3 to the financial statements is understated.
12. Due to a lack of a proper system to account for and identify irregular expenditure I could not perform alternative audit procedures to obtain sufficient appropriate audit assurance as to the completeness of irregular expenditure disclosed in note 30.3 to the financial statements amounting to R165 571 (2009: R409 269).

Contingent liabilities

13. I could not obtain responses from the attorneys of the municipality to my request for information on outstanding legal cases involving the municipality. I could therefore not confirm the completeness of contingent liabilities disclosed in the notes to the financial statements. Due to lack of a proper system to identify and record contingent liabilities I could not perform alternative audit procedures to obtain sufficient appropriate audit assurance as to the completeness of contingent liabilities amounting to R264 400 disclosed in note 35 to the financial statements.

Accounts receivable

14. The provision for bad debts was calculated based on the aging of debtors as per the age analysis. The valuation of the impairment was reviewed and Receivables are considered to be overstated by an estimated amount of R 3 869 649. Furthermore, the entity did not comply with the impairment assessment requirements of the South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133), *Financial instruments: Recognition and measurement* (IAS 39), nor did it apply the impairment valuation methods recommended by the National Treasury. There was insufficient information available in the debtors system to be able to apply the assessment requirements for the provision. This therefore constitutes a material deviation from the reporting framework.

Financial instruments

15. The entity did not discount any of its revenue or expenditure transactions during the year as they occurred as required by IAS 39, nor did it account for the time value at year-end for accounts receivable or accounts payable. As the entity is required to recognise the interest portion as and when the transactions occur and as I could not determine which expenditure items were purchased on credit, I could not reliably estimate the error for expenditure and payables. The error for revenue is estimated at R662 102 and the error for receivables is estimated at R40 338. Comparative amounts were not available for the 2009 financial year.

Qualified opinion

16. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Nketoana Local Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practices and in the manner required by the MFMA.

Emphasis of matter

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

Restatement of corresponding figures

17. As disclosed in note 29 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the 2009-10 financial year in the financial statements of the Nketoana Local Municipality at, and for the year ended, 30 June 2009.

Unauthorised expenditure

18. As disclosed in note 30 to the financial statements, unauthorised expenditure to the amount of R13 212 201 was incurred, as the municipality exceeded its total budget for the year ended 30 June 2010.

Material losses

19. The municipality incurred a loss of R4 734 059 on the disposal of assets due to the overstatement of assets as a result of the application of Directive 4 on provisional accounting for assets.

Additional matters

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

Unaudited supplementary schedules

20. 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

21. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the MFMA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and financial management (internal control).

Predetermined objectives

22. Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirements

- a) The financial plan in the integrated development plan did not include the budget projection for at least the next three years as required by section 26 of the MSA.
- b) The council approved the service delivery and budget implementation plan more than five months after approval of the annual budget instead of within 28 days as required by section 53 of the MFMA.
- c) For the selected objectives, 100% of the planned and reported targets were not:
 - specific in clearly identifying the nature and the required level of performance
 - measurable in identifying the required performance
 - time bound in specifying the time period or dead line for delivery.

Compliance with laws and regulations

Municipal Finance Management Act

The accounting officer did not adhere to his statutory responsibilities

23. Section 69(3) of the MFMA requires the accounting officer to no later than 14 days after the approval of an annual budget, submit to the mayor:
- a draft SDBIP for the budget year
 - drafts of the annual performance agreements as required in terms of section 57(1) of the MSA for the municipal manager and all senior managers.

I could not obtain evidence that the accounting officer submitted these reports to the mayor no later than 14 days after approval of an annual budget.

24. Contrary to section 62(1)(c)(i) of the MFMA, the accounting officer did not comply with his legislative responsibility of managing the financial administration of the municipality by not taking reasonable steps to ensure that:
- the fleet management policy is approved
 - the expenditure policy is approved and implemented in full
 - the policy on delegation of authority matrix is implemented
 - the supply chain management policy is implemented
 - the investment policy is implemented
 - the credit control or debt collection by-law is implemented.

25. The accounting officer did not prepare or table any of the section 32 MFMA reports to the council during the year.

The mayor did not adhere to his legislative responsibilities

26. Contrary to section 53 (1)(c) of the MFMA, the mayor did not ensure that the council approve the municipality's service delivery and budget implementation plan within 28 days after the approval of the annual budget.
27. Contrary to section 53(2) of the MFMA, the mayor did not report to the Municipal council and the MEC for Finance in the Free State on non-compliance relating to the budget, service delivery and budget implementation plan and integrated development plan preparation and implementation.

The audit committee was not functioning properly

28. Contrary to section 166 of the MFMA, the municipality did not have a functional audit committee during the year.

The internal audit unit was not functioning properly

29. Contrary to section 165 of the MFMA, the internal audit unit of the municipality was not functional during the year.

Expenditure was incurred otherwise than in accordance with sections 15 of the MFMA resulting in unauthorised expenditure

30. Contrary to section 15 of the MFMA, expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality. As a result, unauthorised expenditure amounting to R13 254 568 was incurred and this is correctly disclosed in note 30.1 to the financial statements.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

31. Expenditure amounting to R1 902 222 (2009: 6 215 356) was not incurred in accordance with the requirements of the supply chain management policy of the municipality. The non-compliance constitutes "irregular expenditure" as set out in paragraph 1(d) of the MFMA.

INTERNAL CONTROL

32. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA and MSA but not for the purpose of expressing an opinion on the effectiveness of internal control.
33. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

34. Several instances of non-compliance regarding the integrated development plan, service delivery and budget implementation plan and performance management were identified. This reflects the municipal leadership's inability to provide strategic and operational guidance and leadership. It is also apparent that the leadership did not lead by example as several instances were noted where senior officials did not review or approve important reconciliations.

Financial and performance management

35. The municipality relied heavily on the service provider to produce meaningful and accurate financial statements. Several errors were identified in account balances and classes of transactions which point to inadequate review and approval procedures by senior officials.

Governance

36. The municipality's governance structure did not function efficiently during the year. The municipality did not have a functional audit committee. Furthermore, the internal audit is led by an assistant internal audit manager who reports to the chief operating officer. Best practice standards require the internal audit function to be headed by an adequately qualified official who should report administratively to the accounting officer and functionally to the audit committee. The internal audit function should provide internal assurance on the effectiveness of the internal controls of the municipality.
37. The municipality operated without a risk committee or information technology steering committee during the financial year under review.

Auditor-General
Bloemfontein

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

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