

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

REPORT ON THE 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 2011, 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 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 in the manner required by the Local Government: 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. 1 of 2010) (DoRA) and for such internal control as management determines 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. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. 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.

Opinion

7. In my opinion the financial statements present fairly, in all material respects, the financial position of the Nketoana Local Municipality as at 30 June 2011 and its financial performance and cash flows for the year then ended, in accordance with the South African Standards of Generally Recognised Accounting Practices and the requirements of the MFMA.

Emphasis of matters

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

Restatement of corresponding figures

8. As disclosed in note 32 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during the 2010-11 financial year in the financial statements of the Nketoana Local Municipality at, and for the year ended, 30 June 2010.

Unauthorised expenditure

9. As disclosed in note 35 to the financial statements, unauthorised expenditure to the amount of R106 271 406 was incurred, as the municipality had exceeded its total budget for the year ended 30 June 2011.

Irregular expenditure

10. As disclosed in note 37 to the financial statements, irregular expenditure to the amount of R7 642 643 was incurred, which was mainly due to non-compliance with the supply chain management requirements in respect of expenditure transactions.

Material impairments

11. The municipality made a debt impairment provision of R88 618 401 for non-indigent doubtful debts, as disclosed in the balance of the debt impairment in note 9 to the financial statements, due to poor collection practices.

Additional matter

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

Unaudited supplementary schedules

12. 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

13. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I include below my findings on the annual performance report as set out on pages XX to XX and material non-compliance with laws and regulations applicable to the municipality.

Predetermined objectives

Presentation of information

14. The reported performance against predetermined objectives was deficient in respect of the following criteria:
- Performance against predetermined objectives was not reported using the National Treasury guidelines.

The following audit finding relates to the above criteria:

Measures taken to improve performance were not explained in the report on predetermined objectives (Presentation)

15. Adequate measures taken to improve performance were not included in the performance report, as required in terms of section 46(1)(c) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA). In total, 75% of the selected objectives where improvement is required were not explained.

Usefulness of information

16. The reported performance information was deficient in respect of the following criteria:

- Measurability: The indicators are not verifiable and targets are not specific, measurable and time bound.

The following audit findings relate to the above criteria:

Planned and reported targets are not time bound

17. The planned targets were not time bound in specifying the time period or deadline for delivery in 98% of instances.

Planned and reported targets are not specific

18. The planned targets were not specific in clearly identifying the nature and the required level of performance in more than 92% of instances.

Planned and reported indicators are not verifiable

19. Valid performance management processes and systems that produce actual performance against the planned indicators did not exist for 79% of the indicators.

Planned and reported targets are not measurable

20. The planned targets were not measurable in identifying the required performance in more than 31% of instances.

Reliability of information

21. The reported performance information was deficient in respect of the following criteria:

- Validity: The reported performance did not occur and does not pertain to the entity.
- Accuracy: The amounts, numbers and other data relating to reported actual performance have not been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have not been included in the reported performance information.

The following audit findings relate to the above criteria:

The validity, accuracy and completeness of reported performance against targets could not be confirmed as no supporting source information was provided (Reliability)

22. The actual achievements with regard of 72,5% of the selected objectives were not included in the report on predetermined objectives submitted for audit purposes.

23. For the selected programmes, where actual achievements were included in the report, the validity, accuracy and completeness of 100% of the reported targets could not be established as relevant source documentation could not be provided.

Compliance with laws and regulations

Strategic planning and performance management

24. The accounting officer of the municipality did not by 25 January 2011 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.

Budgets

25. The municipality incurred expenditure that was not budgeted for to an amount of R106 271 406, in contravention of section 15 of the MFMA.

Annual financial statements, performance and annual report

26. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current liabilities, expenditure, revenue and disclosure items identified by the auditors were subsequently corrected resulting in the financial statements receiving an unqualified audit opinion.

27. The accounting officer did not make the 2009-10 annual report public immediately after the annual report was tabled in the council, as required by section 127(5) of the MFMA.

28. The municipal council did not adopt an oversight report containing the council's comments on the annual report within two months from the date on which the 2009-10 annual report was tabled in the council, as required by section 129(1) of the MFMA.

Audit committees

29. The audit committee did not function as required by section 166 of the MFMA, in that:

- the audit committee did not advise the council of the municipality on the adequacy, reliability and accuracy of financial reporting and information;
- the audit committee did not review the annual financial statements; and
- the audit committee did not meet at least four times a year.

30. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14.

Internal audit

31. The internal audit unit did not function as required by section 165(2) of the MFMA in that internal audit did not have an approved audit plan for the financial year under review and did not report to the audit committee on the implementation of the internal audit plan.

32. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14.

33. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager, as required by Municipal Planning and Performance Management Regulation 14.

Procurement and contract management

34. 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 Supply Chain Management (SCM) regulation 17(a) & (c).

35. 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) and 36(1).

36. 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).

Human resource management and compensation

37. The municipality did not provide job descriptions for each post in the staff establishment, as required by section 66(1)(b) of the MSA.

Expenditure management

38. The accounting officer did not take reasonable steps to prevent unauthorised expenditure and irregular expenditure, as required by section 62(1)(d) of the MFMA.
39. 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.

Revenue management

40. Revenue received by the municipality was not always reconciled at least on a weekly basis, as required by section 64(2)(h) of the MFMA.
41. The credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA.

INTERNAL CONTROL

42. In accordance with the PAA and in terms of *General Notice 1111 of 2010*, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

43. Oversight responsibility regarding financial and performance reporting and compliance and related internal controls was not exercised as sufficient monitoring controls had not been implemented. It resulted in incomplete performance information and material corrections to the financial statements.
44. Effective HR management was not exercised to ensure that there were job descriptions for each post on the staff establishment.

Financial and performance management

45. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support performance reporting, which resulted in material deficiencies in performance information.
46. Regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information were not prepared, which resulted in material adjustments being made to the financial statements.
47. The review and monitoring of compliance with applicable laws and regulations were not effective, which resulted in significant instances of non-compliance which could have been prevented.

Governance

48. The internal audit unit did not function effectively. This resulted in internal control deficiencies, especially with regard to performance information not being identified and corrective action not being taken.

49. The audit committee did not promote accountability and service delivery by evaluating and monitoring responses to risks and providing oversight of the effectiveness of the internal control environment, including financial and performance reporting and compliance with laws and regulations. This resulted in material non-compliance matters.

OTHER REPORTS

Investigations

50. At the request of the bank, independent forensic auditors are conducting an investigation into alleged fraudulent transactions which occurred on 22 and 25 October 2010 with regard to two bank accounts of the municipality. A charge was laid at a police station and suspects were arrested. The money that was defrauded was partially recovered. The investigation was still ongoing at the reporting date.

Bloemfontein

30 November 2011



A U D I T O R - G E N E R A L
S O U T H A F R I C A

Auditing to build public confidence