

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

## REPORT ON THE FINANCIAL STATEMENTS

### Introduction

1. I have audited the financial statements of the Tokologo Local Municipality set out on pages X to XX, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with 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 of South Africa, 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 these financial statements based on my audit. I conducted my 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. 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.
4. 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.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### Basis for qualification opinion

#### Property, plant and equipment

5. The municipality did not review the residual values and the deemed cost of certain property, plant and equipment at year-end in accordance with SA Standards of GRAP, GRAP 17, *Property, plant and equipment* for the current and prior financial year. Depreciation was furthermore not calculated correctly. I have not determined the correct net carrying amount of property, plant and equipment as it was impracticable to do so. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm the completeness of property, plant and equipment as certain assets could not be found in the asset register while the valuation and existence of certain other assets could not be confirmed. I was unable to confirm the amount



by alternative means. Consequently, I was unable to confirm the balance of property, plant and equipment disclosed as R413 176 474 (2011: R365 688 085) in note 12 to the financial statements and was unable to determine whether any further adjustments were necessary to the amount disclosed for property, plant and equipment.

#### **Accumulated surplus**

6. I was unable to obtain sufficient appropriate audit evidence of the accumulated surplus amounting to R437 345 338 (2011: R405 102 765) as disclosed in the statement of financial position and the statement of changes in net assets due to supporting documentation for various differences that could not be obtained, as well as the limitation on other balances in the statement of financial position. The municipality's available records and information did not permit the application of alternative procedures. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for accumulated surplus.

#### **Cash flow statement**

7. I was unable to obtain sufficient appropriate audit evidence to determine whether the cash flow statement and related notes were fairly stated for the current and prior year. Taking into account the misstatements and limitations identified in the financial statements, as set out in this report, I was unable to practically quantify the misstatements in the cash flow statement and notes thereto. Consequently, I was unable to determine the accuracy, completeness and correct disclosure of the cash flow statement and related notes.

#### **Revenue**

8. I was unable to obtain sufficient and appropriate audit evidence for service charges amounting to R 16 491 489 (2011: R14 358 613) disclosed in note 18 to the financial statements as certain differences between meter readings and the revenue levied could not be explained by management. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the amount disclosed for service charges.
9. Property rates were not updated with property transfers. Furthermore, a supplementary valuation was not performed, which could result in the under-levying of property rates. I have not determined the correct amount as it was impractical to do so. Consequently, I could not confirm the accuracy and completeness of property rates amounting to R2 343 116 (2011: R1 701 085) as disclosed in note 20 to the financial statements.

#### **Irregular expenditure**

10. I was unable to verify the completeness of the irregular expenditure of R49 624 771 (2011: R44 558 455) as disclosed in note 44 to the financial statements due to the fact that sufficient appropriate audit evidence could not be obtained that all payments had been approved by the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA, and because certain documents were not provided for audit purposes. I was unable to confirm the completeness of irregular expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were required to the amount disclosed for irregular expenditure.

#### **Value-added tax (VAT) receivable**

11. I was unable to obtain sufficient appropriate audit evidence to confirm the valuation and completeness of VAT amounting to R7 712 353 (2011: R3 108 223) as disclosed in note 6 to the financial statements due to differences between the VAT 201 returns and the general ledger. I was unable to confirm this amount by alternative means. Consequently, I was unable to determine whether any adjustments were required to the amount disclosed for VAT.

## Consumer debtors

12. Sufficient appropriate audit evidence for consumer debtors to the amount of R49 903 850 (2011: R43 749 915), as disclosed in note 5, could not be obtained as differences between the opening and closing balances as well as differences between the note and the age analysis could not be explained. I was unable to confirm these amounts by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the amount disclosed for consumer debtors.

## Employee benefits

13. International Accounting Standard, IAS 19, *Employee benefits*, outlines the recognition and requirements pertaining to employee benefits. Contrary to these requirements, the municipality did not disclose post-retirement benefits and long-service awards for the current and prior year. In the absence of appropriate records and information, I was unable to confirm the valuation, allocation and completeness of employee benefits for the current and prior year. Consequently, I was also not able to determine the effect on the other account balances and classes of transactions contained in the financial statements.

## Budget statement

14. SA Standards of GRAP, GRAP 1, *Presentation of financial statements*, requires that financial statements should include a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements. No information was included in the financial statements in this regard.

## Financial instruments

15. International Financial Reporting Standards, IFRS 7, *Financial instruments: Disclosures*, requires the disclosure of information on liquidity risks, maturity analysis, sensitivity analysis and credit risk exposure relating to financial instruments. Contrary to the minimum disclosure requirements, the municipality's exposure to financial risks and how these risks were mitigated were not disclosed in the financial statements.

## Aggregation/Accumulation of immaterial uncorrected misstatements

16. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, the statement of financial performance and the notes to the financial statements:

### Statement of financial position

- Inventory reflected as R379 319 is overstated by R211 224
- Leave payouts and gratuities is overstated by R55 459
- Receivables from non-exchange transactions understated by R 474 719

### Statement of financial performance:

- Government grants and subsidies reflected as R103 794 124 is understated by R27 000
- Rental of facilities reflected as R503 765 is understated by R26 584
- Interest earned reflected as R798 493 is overstated by R10 633
- Depreciation reflected as R19 248 673 is understated by R223 535
- Finance costs reflected as R256 940 is understated by R105 694
- General expenses reflected as R6 818 405 is understated by R605 312

### Disclosure notes

- Contingent liabilities reflected as R10 000 000 is understated by R448 403
- Fruitless and wasteful expenditure reflected as R595 927 is understated by R138 372



17. In addition, I was unable to obtain sufficient appropriate audit evidence of non-material items included in the following balances or verify them by alternative means:

- Finance lease obligations reflected as R677 929
- Finance costs reflected as R256 940
- Repairs and maintenance reflected as R3 967 501
- Bulk purchases reflected as R11 894 519
- Contracted services reflected as R7 150 754
- General expenditure reflected as R6 818 405

As a result, I was unable to determine whether any further adjustments to these elements were necessary.

### **Qualified opinion**

18. In my opinion, except for the 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 Tokologo Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

### **Emphasis of matters**

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

### **Restatement of corresponding figures**

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

### **Unauthorised expenditure**

21. As disclosed in note 42 to the financial statements, the municipality incurred unauthorised expenditure of R36 221 598 (2011: R 32 329 251) during the year under review due to the municipality exceeding their approved budget.

### **Additional matter**

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

### **Unaudited supplementary schedules**

23. The supplementary information set out on pages X 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**

24. 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**

25. The annual performance report included in the annual report was not presented in time for audit and consequently my findings below are limited to the procedures performed on the strategic planning and performance management documents.



26. The information was assessed to determine whether performance 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*.

#### **Usefulness of information**

27. The integrated development plan (IDP) submitted for audit purposes did not include the performance indicators with the result that I could not confirm whether the performance indicators are measurable and relevant.

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

28. I performed procedures to obtain evidence that the entity had 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**

29. The municipality did not conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and municipal planning and performance management (MPPM) regulation 6.
30. The municipality did not establish a performance management system that is in line with the priorities, objectives, indicators and targets contained in its IDP, did not clarify the roles and responsibilities of each role player in the functioning of the system, did not determine the frequency of reporting and the lines of accountability for performance, did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38(a) of the MSA and MPPM regulation 7(2)(c), (e), (f) and (g).
31. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA, nor set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its IDP.

#### **Budgets**

32. Expenditure was incurred in excess of the limits provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
33. Quarterly reports were not submitted to the council on the implementation of the budget and financial state of affairs of the municipality within 30 days after the end of each quarter, as required by section 52(d) of the MFMA.
34. Monthly budget statements were not submitted to the mayor and the relevant provincial treasury, as required by section 71(1) of the MFMA.

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

35. 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 current assets, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records provided, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

36. 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.
37. A written explanation was not submitted to council setting out the reasons for the delay in the tabling of the 2010-11 annual report in the council, as required by section 127(3) of the MFMA.
38. The accounting officer did not make the 2010-11 annual report public immediately after the annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.
39. The municipal council did not adopt an oversight report containing comments on the annual report within two months from the date on which the 2010-11 annual report was tabled, as required by section 129(1) of the MFMA.
40. The accounting officer did not make public the council's oversight report on the 2010-11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.

#### **Internal audit**

41. The internal audit unit did not assess the functionality of the performance management system, as required by MPPM regulation 14(1)(b)(i).

#### **Audit committee**

42. The audit committee did not advise the council on matters relating to performance management and performance evaluation, as required by section 166(2)(a) of the MFMA.
43. As the quarterly reports on performance management were not submitted to the performance audit committee, they could not review the municipality's performance management system and make recommendations to the council, as required by MPPM regulation 14(4)(a)(ii), review all the quarterly internal audit reports on performance measurement, as required by MPPR regulation 14(4)(a)(i) and 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 MPPM regulation 14(4)(a)(iii).

#### **Procurement and contract management**

44. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, due to information not being available when requested for audit.
45. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R200 000 were procured by means of inviting competitive bids and that deviations were approved by the accounting officer only if it was impractical to invite competitive bids, as required by supply chain management (SCM) regulations 19(a) and 36(1).
46. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
47. Proof was not provided that allegations of fraud and the failure to comply with the SCM system made against officials were investigated, as required by SCM regulation 38(1)(b)
48. A list of accredited prospective providers was not in place for procuring goods and services through quotations, as required by SCM regulation 14(1)(a).

#### **Human resource management and compensation**

49. Appointments were made in posts which were not provided for on the approved staff establishment of the municipality, in contravention of section 66(3) of the MSA.
50. Job descriptions were not established for all posts in which appointments were made in the current year, in contravention of section 66(1)(b) of the MSA.

51. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by the regulations on minimum competency levels regulation 14(2)(b).

### **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. Payments were made without the approval of the accounting officer or a properly authorised official, as required by section 11(1) of the MFMA.
54. An effective system of expenditure control, including procedures for the approval, authorisation, withdrawal and payment of funds, was not in place as required by section 65(2)(a) of the MFMA.
55. The accounting officer did not take reasonable steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d).
56. Unauthorised, irregular, fruitless and wasteful expenditure was not investigated and as a result was not recovered from the liable person, as required by section 32(2) of the MFMA.

### **Conditional grants**

57. The municipality did not evaluate its performance in respect of programmes funded by the allocation within two months after the end of the financial year, as required by section 12(6) of DoRA.
58. The municipality did not register its master plans for bulk infrastructure with the integrated national electrification programme (INEP), as required by the *Division of revenue grant framework, Government Gazette No. 34280*.
59. Projects were not implemented in line with the details contained in the IDP, as required by the *Division of revenue grant framework, Government Gazette No. 34280*.

### **Revenue management**

60. A tariff policy on the levying of fees for municipal services provided by the municipality was not implemented, as required by section 74(1) of the MSA and section 62(1)(f)(i) of the MFMA.
61. A credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of MFMA.
62. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.
63. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
64. Accounts for municipal tax and charges for municipal services were not prepared on a monthly, as required by section 64(2)(c) of the MFMA.

### **Asset management**

65. An adequate management, accounting and information system which accounts for assets was not in place throughout the year, as required by section 63(2)(a) of the MFMA.

### **Liability management**

66. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.
67. A management, accounting and information system which adequately accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

## **Environmental management**

68. The municipality operated their waste disposal sites without a waste management licence or permit, in contravention of section 20(b) of the National Environmental Management: Waste Act, 2008 (Act No. 59 of 2008) and section 20(1) of the Environmental Conservation Act, 1989 (Act No. 73 of 1989).

## **Financial misconduct**

69. All instances of financial misconduct were not reported to the South African Police, as required by section 62(1)(e) and the *Disciplinary regulations for senior managers* 8(4).
70. Investigations were not instituted into all allegations of financial misconduct against officials of the municipality, as required by section 171(4)(a) of the MFMA.

## **Internal control**

71. I considered internal control relevant to my audit of the financial statements, 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 qualified opinion, and the findings on compliance with laws and regulations included in this report.

## **Leadership**

72. The accounting officer did not exercise its oversight responsibility regarding financial and performance reporting and compliance and related internal controls.
73. The municipality developed a plan to address audit findings, but adherence to the plan was not monitored on a timely basis by the appropriate level of management to ensure proper execution before year-end.
74. The municipality did not have sufficient skilled staff members, especially at middle management level, to ensure proper internal control and service delivery to the community.
75. The accounting officer did not establish an IT governance framework that supports and enables the business, delivers value and improves performance.

## **Financial and performance management**

76. The chief financial officer did not prepare, accurate and complete financial and performance reports that are supported and evidenced by reliable information. This is evidenced by the numerous corrections that had to be made in the financial statements and by the late submission of the report on performance information.
77. An overall lack of monitoring and evaluation by senior management to ascertain whether components of internal control are functioning was evident.
78. Senior management did not monitor adherence to policies and procedures, resulting in numerous instances of non-compliance with the laws and regulations.

## **Governance**

79. The accounting officer did not implement appropriate risk management activities to ensure the proper managing of risks, including the consideration of IT risks and fraud prevention.
80. The internal audit unit did not function adequately and did not identify internal control deficiencies and recommend corrective action effectively.



81. As the municipality did not submit performance management to the audit committee, the audit committee could not advise the council on matters relating to performance management and performance evaluation as the municipality did not submit.

*Auditor-General*  
Bloemfontein

30 November 2012



AUDITOR-GENERAL  
SOUTH AFRICA

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