

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

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Tswelopele 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

Property, plant and equipment

7. Property, plant and equipment could not be physically verified due to the fact that the asset register did not contain adequate descriptions, serial numbers, locations and condition of the property, plant and equipment to physically confirm the existence and completeness of the assets. The existence of the infrastructure assets could also not be confirmed owing to vague and unclear descriptions or insufficient detail with regard to the location of the assets. The municipality's accounting records did not permit the application of reasonable alternative procedures to confirm the existence and completeness of the municipality's property, plant and equipment amounting to R251 737 584 (provisional value as per Directive 4) as disclosed in the statement of financial position and note 6 to the financial statements.
8. Contrary to the requirements of the transitional provisions for the implementation of the SA standard of GRAP17, *Property, plant and equipment* for medium and low-capacity municipalities, a disclosure note regarding the progress with the measuring of property, plant and equipment were insufficiently disclosed in note 6 to the financial statements.

Accounts receivable

9. 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 is considered to be fair. However, the entity did not comply with the impairment assessment requirements as per South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC133), *Financial Instruments: Recognition and measurement* (IAS39), 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 constitutes a material deviation from the reporting framework.

Contingent liabilities

10. I could not obtain responses from all the attorneys of the municipalities to our request for information on outstanding legal cases involving the municipality. I could therefore not confirm the completeness of contingent liabilities to an amount of R934 863 disclosed in note 44.1 to the financial statements.

Financial instruments

11. The entity did not discount any of its revenue 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. The estimated error for revenue is R 974 802 (2009: R780 700) and for receivables it is R18 133 (2009: R19 130).

Qualified opinion

12. 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 Tswelopele 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 matters

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

Significant uncertainties

13. With reference to disclosure note 12 to the financial statements, the value-added tax (VAT) receivable amount of R1 297 113 is pending the outcome of an audit by the South African Revenue Service (SARS) on the VAT201 forms submitted during the financial year. During the financial year the VAT201 forms were incorrectly completed and submitted to SARS, which caused the accounting records to differ from the VAT201 forms. An uncertainty therefore exists regarding the amount receivable that SARS will allow the municipality to claim.

Restatement of corresponding figures

14. As disclosed in note 39 to the financial statements, the corresponding figures for 30 June 2009 have been restated as a result of an error discovered during the 2009-10 financial year in the financial statements of the Tswelopele Local Municipality at, and for the year ended, 30 June 2009.

Unauthorised expenditure

15. As disclosed in note 40.1 to the financial statements, unauthorised expenditure to the amount of R6 791 189 was incurred due to the overspending of the budget under the electricity vote to the amount of R988 911 and capital expenditure to the amount of R5 802 278.

Additional matters

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

Material inconsistencies in other information included in the annual report

16. The annual report has not been received at the date of this report and therefore we cannot conclude on inconsistencies in the annual report.

Unaudited supplementary schedules

17. 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

18. 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 following key laws and regulations: MFMA, Local Government: Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) and financial management (internal control).

Predetermined objectives

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

Non-compliance with regulatory and reporting requirements

Municipal Finance Management Act

Existence and functioning of a performance audit committee

20. The municipality did not appoint a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations.

Internal auditing of performance measurements

21. The internal auditors of the municipality did not audit the performance measurements on a continuous basis nor did they submit quarterly reports to the municipal manager and a performance audit committee.

Lack of adoption of a performance measurement system

22. The municipality did not adopt 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, and the roles of the different role players, as required in terms of sections 36, 38, and 41(2) of the MSA, and regulations 7 and 8 of the Municipal Planning and Performance Management Regulations.

Usefulness of information

Inadequate content of the integrated development plan

23. The integrated development plan of the municipality does not reflect the financial plan which includes the budget projection for at least three years.
24. The integrated development plan review for the year 2009-10 of the municipality does not document the project specifications and feasibility studies of municipal infrastructure grants (MIG) projects.

Reported information not consistent with planned objectives, indicators and targets

25. The annual performance report for the year 2009-10 does not include all the indicators/ measures and targets for the development priorities as per the integrated development plan.

Reliability of information

26. Sufficient appropriate audit evidence in respect of any of the selected programmes could not be obtained to perform satisfactory audit procedures. I could therefore not obtain the required assurance as to the validity, accuracy and completeness of the reported information.

Compliance with laws and regulations

Municipal Finance Management Act

The audit committee was not properly established or not functioning properly

27. Contrary to the requirements of section 166(2) (b) of the MFMA, the audit committee did not provide the council of the municipality with an authoritative and credible view of the financial position of the municipality, its efficiency and effectiveness and its overall level of compliance with the MFMA, DoRA and any other applicable legislation.
28. Contrary to the requirements of section 166(5) of the MFMA, the chairperson of the audit committee was not appointed by the council of the municipality.

Supply chain management (SCM) legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

29. Contrary to SCM regulation 46(2)(e) and schedule 1, paragraph 7, of the MSA annual declarations of interest were not made by some of the councillors.
30. Contrary to the requirements of section 41(2) of the MFMA, a risk assessment was not performed for the identification, consideration and avoidance of potential risks in the SCM system.

The financial statements were not prepared in accordance with applicable legislation

31. Contrary to the requirements of section 62(1)(c) of the MFMA, the municipality did not maintain effective, efficient and transparent systems of internal control as required by legislation for assets.

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

32. Contrary to the requirements of 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 per note 40.1 on unauthorised expenditure.

INTERNAL CONTROL

- 33. 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, MSA and SCM Regulations, but not for the purpose of expressing an opinion on the effectiveness of internal control.
- 34. The matters reported below are limited to the significant deficiencies regarding the basis for qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

- 35. The accounting officer did not implement sufficient internal control measures to ensure compliance with laws, regulations, accounting standards and internal policies and procedures. The lack of proper oversight on financial reporting in the annual financial statements resulted in numerous corrections being made to the financial statements. The delay in implementing procedures and processes in ensuring proper asset management had and may continue to have a detrimental impact on financial reporting as reported on in the basis for qualified opinion above.

Financial and performance management

- 36. The municipality relied to a great extent on a service provider to produce meaningful and accurate financial statements, but a lack of efficient and effective oversight by management on the initial transactions and impact of the accounting policies caused a significant number of corrections to be made to the annual financial statements.
- 37. The absence of oversight and control by the accounting officer over asset management contributes to the lack of financial control by not ensuring timely and detailed information being captured during initial recognition.

Governance

- 38. The chairperson was elected by the audit committee members contrary to the legislative requirement.
- 39. Although the annual financial statements were submitted to the audit committee, the extent of weaknesses and non-adherence to accounting policies were not reported to the council.

40. Although the municipality conducted a risk assessment, which includes a fraud prevention plan, the accounting officer did not implement a risk management strategy to mitigate the risk efficiently, resulting in control weaknesses, non-compliance with legislation and incomplete implementation of the accounting policies.

Bloemfontein

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence



AUDITOR - GENERAL
SOUTH AFRICA

The accounting officer
Municipality Manager
Tswelopele Local Municipality
P.O. Box 3
Bultfontein
9670

Date: 26 November 2010

Reference: 21385REG09-10

Dear Mr. Motlhale

MANAGEMENT REPORT ON THE REGULARITY AUDIT OF THE TSWELOPELE LOCAL MUNICIPALITY FOR THE YEAR ENDED 2010-06-30

INTRODUCTION

1. This management report is provided in connection with our audit of the financial statements and the review of the performance information for the year ended 30 June 2010.
2. The report contains the following main subsections:
 - The Auditor-General's responsibilities
 - The Accounting officer's responsibilities
 - Misstatements in the financial statements
 - Matters to be drawn to the attention of the users
 - Other legal and regulatory reporting requirements
 - Information technology systems
 - Specific focus areas
 - Details of significant deficiencies in internal control relevant to the audit of the financial statements reporting on predetermined objectives and compliance with laws and regulations
 - Remedial action taken on audit outcomes of prior years
 - Matters that may give rise to future audit findings if not addressed
 - Ratings of the audit findings
 - Summary of detailed audit findings
3. Annexures A, B, and C contain information on the detailed audit findings. The detailed findings were communicated during the course of the audit and include management's responses thereto.

THE AUDITOR-GENERAL'S RESPONSIBILITIES

4. Our responsibility is to express an opinion on the financial statements and to report on findings related to our review of the report on predetermined objectives and compliance with key laws and regulations. Our engagement letter sets out our responsibilities in detail. These include the following:
 - Planning and performing the audit to obtain reasonable assurance about whether the financial statements and report on predetermined objectives are free from material misstatements, whether caused by fraud or error.
 - Performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and report on predetermined objectives. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements.
 - Considering internal controls relevant to the entity's preparation and fair presentation of the financial statements and report on predetermined objectives, and compliance with laws and regulations.
 - Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management.
 - Evaluating compliance with applicable legislation relating to financial matters, financial management and other related matters.
 - Evaluating the appropriateness of systems and processes to ensure the accuracy and completeness of reporting on predetermined objectives
 - Evaluating the overall presentation of the financial statements.
 - Expressing an opinion on the financial statements based on the audit in accordance with the International Standards on Auditing (ISAs).
 - Reading other information in documents containing the audited financial statements.
5. Because of the test nature and other inherent limitations of an audit, we do not guarantee the completeness and accuracy of the financial statements or report on predetermined objectives, or compliance with all applicable legislation.
6. Having formed an opinion on the financial statements we may include additional communication in the auditor's report that does not have an effect on the auditor's opinion, the following paragraphs could be included in the auditor's report:
 - An Emphasis of matter paragraph only to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements.
 - An Additional matter paragraph to draw users' attention to any matter other than those presented or disclosed in the financial statements that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

THE ACCOUNTING OFFICER'S RESPONSIBILITIES

7. The accounting officer's responsibilities are set out in detail in the engagement letter. These include the following:
 - The preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practises, (GRAP).
 - Designing, implementing and maintaining internal controls relevant to the preparation of the financial statements.

- Selecting and applying appropriate accounting policies, and making accounting estimates that are appropriate in the circumstances.
- Disclosing known instances of non-compliance or suspected non-compliance with laws and regulations, of which the effects should be considered when preparing financial statements.
- Monitoring and reporting on performance against predetermined objectives.
- Providing access to all information that is relevant to the preparation of the financial statements and performance information, such as records, documents and other matters.
- Disclosing all matters concerning any risk, allegation or instances of fraud.
- Accounting for and disclosing related party relationships and transactions.

SUMMARY OF DETAILED AUDIT FINDINGS

Page. no.	Finding	Classification					Rating			In which years was it reported		
		Financial statements	Predetermined objectives	Compliance	Internal control	Service delivery	Matters affecting the auditor's report	Other important matters	Administrative matters	2008/09	2007/08	2006/07
27	Uncorrected misstatements in the current year (EX.138)	✓					✓			✓		
Cash and cash equivalents												
28	Petty cash- Not disclosed in the financial statements (EX.98)	✓					✓					
Contingent liabilities												
29	Contingent Liabilities - Completeness (EX.142)	✓					✓					
Employee costs												
30	Leave, payout and gratuities: 48 day maximum exceeded (EX.69)	✓					✓					
79	Staff Leave: Journals on provision account - 7201/7204/7202 (EX.135)				✓			✓				
81	Employee Cost: Financial statements to trial balance (EX.42)				✓			✓				
82	Employee Cost: Overtime exceeding 10 hours per week (EX.62)				✓			✓		✓		
84	Employee Cost: Wages errors (EX.63)				✓			✓		✓		
86	Leave, payout and gratuity: Annual leave errors (EX.67)				✓			✓		✓		

88	Leave, payouts and gratuities: Family responsibility leave proof (EX.71)				✓			✓				
90	Leave, payout and gratuities: Maximum of 48 days leave balance (EX.74)				✓			✓				
92	Employee Cost: Salary run not approved (EX.77)				✓			✓				
93	Leave, payout and gratuities: Attendance register not signed regularly (EX.97)				✓			✓				
Planning												
32	Audit Committee - Chairperson not approved by council (not appointed) (EX.23)			✓			✓					
95	Revenue- No policies and procedures (EX.1)				✓			✓		✓		
96	No policies for the identification of fruitless and wasteful expenditure, unauthorised expenditure and irregular (EX.10)				✓			✓				
97	Internal control - Audit committee charter not approved by council. (EX.17)			✓				✓				
98	Overall understanding at financial statement level- Organisational structure is not adequate (EX.3)				✓			✓				
99	Financial Statements: Lead sheets in audit working paper file (EX.44)				✓			✓				
100	Internal control - All relevant committees not established (EX.5)				✓			✓		✓		
101	Internal control - shortcoming of risk assessment process (EX.6)				✓			✓				
103	Overall understanding at financial statement - No control or procedure in place to identify subsequent events. (EX.33)				✓			✓				
104	Overall understanding at financial statement level - Performance assessment not conducted for managers (EX.4)				✓			✓		✓		
Immovable assets												

33	MIG - IDP does not include the components of the MIG Projects (EX.82)				✓		✓					
105	Investment Property: Lease contract not signed by the Lessee's representatives (EX.27)				✓			✓				
Inventory												
106	Inventory - Stock register not updated and reconciliations not performed (EX.15)				✓			✓		✓		
107	Inventory : Stock requisition form not signed (EX.16)				✓			✓				
108	Inventory - Understated (EX.53)				✓			✓		✓		
110	Inventory: No Fuel register for Bultfontein. (EX.57)				✓			✓				
111	Inventory: No explanation on significant variances. (EX.72)				✓			✓		✓		
Movable assets												
34	Property, plant and equipment - non compliance to GRAP 1 (EX.51)	✓					✓					
35	Property, plant and equipment - maintaining inadequate fixed assets register: Assets not verified (EX.55)	✓					✓					
113	Property, plant & Equipment: Assets Management Policy in Draft Format. (EX.11)				✓			✓				
114	Transactions not continuously recorded in the asset register (EX.13)				✓			✓		✓		
115	Property, plant & equipment - property, plant and equipment not adequately insured. (EX.54)				✓			✓		✓		
116	Property, plant & Equipment and Intangible Assets: Inadequate Internal Controls implemented around the asset component. (EX.9)				✓			✓				
Operating expenditure												
42	SCM: Contravention to Code of Conduct for Councillors (EX.117)			✓			✓					

43	Expenses: Transactions not recorded on the correct amount and in the correct period/Transactions incorrectly classified (EX.109)	✓					✓					
118	Expenses: Non-Compliance with the Supply Chain Management laws and regulations (EX.111)			✓				✓				
122	Procurement of MIG projects - Composition Specification committee not accordance with SCM (EX.132)			✓				✓				
123	Procurement for MIG projects - stakeholder's comments not obtained. (EX.134)			✓				✓				
Payable												
45	Trade and other payables : Expenditure incorrectly debited to creditors' account (EX.102)	✓					✓			✓		
47	Consumer deposits- Deposit list does not agree with financial statements (EX.81)	✓					✓			✓		
49	Trade and other payables : Cons bill Incorrectly classified as creditors (EX.88)	✓					✓				✓	
124	Trade and other payables: Credit purchases have an opening balance. (EX.103)				✓			✓				
125	Trade and other payables : Suspense account not closed off at year end (opening balance) (EX.107)	✓						✓				
126	Trade and other payables: Accrual lists not submitted. (EX.130)				✓			✓				
127	Payables: Monthly Creditors Reconciliations are not performed. (EX.52)				✓			✓				
128	Trade and other payables: Opening balance incorrectly transferred. (EX.86)				✓			✓				
Performance information												
50	Performance Information - Integrity of the source information processing (EX.119)		✓				✓					
51	Performance Information - Audit criteria for		✓				✓			✓		

	Existence on the Draft Annual Performance Report could not be confirmed. (EX.125)											
52	Performance Information - The relevance and Presentation of the Performance Report not confirmed (EX.126)		✓				✓					
53	Performance Information - The design and operation of the performance management information not clear (EX.144)		✓				✓			✓		
54	Performance Information - No evidence for the electricity needs performed (EX.145)		✓				✓			✓		
55	Performance Information - No control to address significant risks for performance information (EX.146)		✓				✓			✓		
56	Performance Information - Audit criteria could not be confirmed (EX.147)		✓				✓			✓		
57	Performance Information -Draft Annual Performance Report not Consistent with the IDP Review (EX.91)		✓				✓					
129	Performance Information - IDP not identifying the minimum required items (EX.29)		✓					✓				
130	Internal control planning checklist - Control environment for performance information (EX.7)				✓			✓			✓	
132	Internal control - Roles and responsibilities not clearly documented (Performance information) (EX.8)				✓			✓		✓		
Receivables												
58	Trade Receivables: IAS 39 Compliance (EX.143)	✓					✓					
59	Trade Payables and Trade Receivables: Discounting in terms of IAS 39 (EX.148)	✓					✓					
60	Other receivables: No supporting documentation for prior year error. (EX.141)	✓					✓					
61	Other receivables: Amounts for Prepayments could	✓					✓					

	not be verified. (EX.93)											
134	Debtors: Debtor not disclosed according to the customer classification (EX.30)				✓			✓				
Reserves												
62	Accumulated surplus: Prior period error Disclosure (EX.133)	✓					✓					
135	No policies and procedures regarding Unspent grants and Reserves (EX.35)				✓			✓				
Revenue												
64	Revenue- No supporting documentation could be obtained for the following revenue items. (EX.104)	✓					✓					
66	Revenue - Amount charged for rentals does not agree to the rental agreement (EX.106)	✓					✓					
68	Revenue - Property rates incorrectly calculated (EX.110)	✓					✓					
69	Revenue- Interest Charged cannot be agreed to the recalculated interest (EX.129)	✓					✓					
71	Revenue: Differences between the receipts and amount disclosed in AFS (EX.59)	✓					✓					
72	Revenue- Interest in the cheque account from the bank confirmation does not agree to GL (EX.83)	✓					✓					
73	Revenue-Rental General- Lease agreement has expired (EX.95)	✓					✓					
136	Revenue - Cut-off procedures not confirmed. (EX.105)	✓						✓				
138	Revenue- Rateable reconciliation does not have rates recalculation (EX.122)				✓			✓				
139	Revenue- Property valuation does not comply to Property rates act (EX.48)			✓				✓				
140	Revenue: Extension on the Buildings were not revalued (EX.60)				✓			✓				

142	Revenue: Rates - The municipality does not have website (EX.61)			✓				✓				
143	Revenue - No direct income register (EX.84)				✓			✓				
144	Revenue- The was no escalation clause in the lease agreements (EX.96)				✓			✓				
Taxes												
74	VAT - Vat output, input and net in VAT 201 does not agree to general ledger (EX.127)	✓						✓				
76	VAT - Vat on fringe benefits (EX.123)	✓						✓				
77	Vat- Incorrect vat on prepayments (EX.124)	✓						✓				
145	VAT - No evidence that the journal passed were approved. (EX.121)				✓			✓				
146	VAT: Inadequate Internal Controls in the VAT component. (EX.50)				✓			✓				

